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Supreme Court of the United States

ASWORTH, LLC (f/k/a Asworth Corporation); HTF, LLC (f/k/a HT-Forum, Inc.); and D AVIATION SERVICES, LLC (f/k/a D Aviation Services, Inc.)

Petitioners,

v.

DEPARTMENT OF REVENUE, FINANCE AND ADMINISTRATION CABINET, COMMONWEALTH OF KENTUCKY (f/k/a Revenue Cabinet, Commonwealth of Kentucky)

Respondent.

ON PETITION FOR A WRIT OF CERTIORARI TO THE KENTUCKY COURT OF APPEALS

PETITION FOR A WRIT OF CERTIORARI

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QUESTIONS PRESENTED

1. Whether a State violates the Commerce Clause of the U.S. Constitution by subjecting an out-of-state corporate partner to income tax when the partner has no property or employees in the State and the partner's only connection with the State is the holding of passive investment interests in entities that have in-state business operations?

2. Whether a State violates the Due Process Clause of the U.S. Constitution by enacting non-curative tax legislation that retrospectively denies interest on overpayments of court-ordered tax refunds on a retroactive basis of up to 17 years?

RULE 29.6 STATEMENT

Asworth, LLC, formerly known as Asworth Corporation ("Asworth"), does not have a parent corporation nor any publicly held corporation that owns 10% or more of its stock.

HTF, LLC, formerly known as HT-Forum, Inc. ("HTF"), does not have a parent corporation nor any publicly held corporation that owns 10% or more of its stock.

D Aviation Services, LLC, formerly known as D Aviation Services, Inc. ("D Aviation"), does not have a parent corporation nor any publicly held corporation that owns 10% or more of its stock.

HTF and D Aviation are both 100% owned by Asworth.

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PETITION FOR A WRIT OF CERTIORARI

Petitioners respectfully petition this Court for a Writ of Certiorari to review the Opinion of the Kentucky Court of Appeals rendered on November 20, 2009.

OPINIONS BELOW

The Opinion of the Kentucky Court of Appeals is unreported and is reprinted in its entirety in Petitioners' Appendix ("Pet. App."). The Supreme Court of Kentucky's Order of August 18, 2010 denying Petitioners' Motion for Discretionary Review is also unreported and is reprinted at Pet. App. 46a. The Order of the Franklin Circuit Court is also unreported and is reprinted at Pet. App. 34a. The Order of the Kentucky Board of Tax Appeals is likewise unreported and is reprinted at Pet. App. 27a.

JURISDICTION

The Opinion for which certiorari is sought, issued by the Kentucky Court of Appeals, was rendered on November 20, 2009. Pet. App. 1a. Petitioners timely filed a Motion for Discretionary Review with the Supreme Court of Kentucky on December 18, 2009, which was denied on August 18, 2010. Pet. App. 46a. This Court has jurisdiction pursuant to 28 U.S.C. § 1257(a).

CONSTITUTIONAL AND STATUTORY PROVISIONS INVOLVED

The constitutional provisions involved are the Commerce and the Due Process Clauses of the U.S. Constitution.

The Commerce Clause provides: "the Congress shall have Power . . . To regulate Commerce with foreign Nations, and among the several States, and with the Indian Tribes." U.S. CONST. art. I, § 8.

The Due Process Clause of the Fourteenth Amendment to the U.S. Constitution provides, in pertinent part: "[N]or shall any state deprive any person of life, liberty, or property, without due process of law." U.S. CONST. amend. XIV, § 1.

The Kentucky statutory provisions involved in this case are set forth at Pet. App. 47a, all of which are subservient to the constitutional sections cited here.

INTRODUCTION

A. Physical Presence – *Quill Corp. v. North Dakota*

This Petition for a Writ of Certiorari presents the important question of whether the Commerce Clause permits a state to impose income tax on an out-of-state corporate partner having no in-state physical presence, for no reason other than it is a passive investor in an entity that does business in the taxing state. For nearly 20 years, this question has been litigated in countless forums with conflicting outcomes. This Court should intervene to address whether states have the power and authority to reach across jurisdictional lines and subject out-of-state corporate partners to taxation when they maintain no property or employees in the taxing jurisdiction. This issue is as fundamental as the Commerce Clause and is of pressing significance to American business.

Many states are exceeding the constitutional limits of power as set forth in the Commerce Clause and as proclaimed by this Court, holding that physical presence is not a predicate to taxing income, in plain violation of this Court's holdings in *Nat'l Bellas Hess, Inc. v. Dep't of Revenue of Illinois*, 386 U.S. 753 (1967) and *Quill Corp. v. North Dakota*, 504 U.S. 298 (1992). Other states are following these dictates and the decisions of this Court, correctly holding that physical presence is required before states may subject out-of-state companies to income tax.

This issue has been litigated in appellate courts of at least 20 states and many lower forums with conflicting results. Simply put, the courts are in a state of chaos on whether physical presence is required as a constitutional predicate prior to taxation. Some courts, such as the court below in this case, have held that out-of-state partners are subject to state income taxation based solely on the holding of passive investment interests, even in the face of the partner having no physical presence in the taxing state. Other states have held to the contrary. Further, at least 35 states have enacted legislation, regulations or policies applying what state tax expert Professor Richard D. Pomp has referred to as a "metaphysical presence" test in income tax settings and stating that holding a partnership interest alone creates tax nexus. Many states are thus flouting this Court's physical presence requirement in *Quill*.

Beyond Kentucky, the lower court's decision will have significant impact on tax administration and enforcement in every state. The detrimental effect of

the decision affects corporate taxpayers since it wrongly preempts and substitutes this Court's Commerce Clause "physical presence" standard with a Due Process "protection and benefits" standard. This Court's intervention is necessary to ensure that taxpayers, legislators, and administrators are appropriately advised regarding the valid constitutional parameters of state tax nexus or jurisdictional authority to tax. If not, and were the lower court's decision left to stand, virtually every out-of-state taxpayer receiving investment income from a company operating in another state will now be subject to that state's taxation.

As Justice White accurately predicted, it was a "sure bet" that the "vagaries of 'physical presence'" and the scope of the *Quill* Opinion "will be tested to their fullest in our courts." *Quill*, 504 U.S. at 331 (White, J., concurring in part and dissenting in part). As the *Quill* majority admitted, "our law in this area is something of a 'quagmire' and the 'application of constitutional principles to specific state statutes leaves much room for controversy and confusion and little in the way of precise guides to the states in the exercise of their indispensable power of taxation.'" *Quill*, 504 U.S. at 315-16. The avalanche of litigation on whether the physical presence rule governs income taxes or only sales and use taxes, post-*Quill*, demonstrates intervention is needed.

Many states, including Tennessee, Texas and Michigan, correctly analyzed *Quill* and held that this Court's affirmation of the physical presence rule in the sales and use tax setting did not equate to a rejection of that rule in other state tax (*e.g.*, income tax) settings.

Accordingly, these states held that non-resident companies with no in-state property, representatives or employees were not subject to state income or franchise taxes.

However, other states have misread *Quill*, holding that the physical presence rule is limited to sales and use taxes and does not apply to income taxes or other taxes. Tellingly, most states that upheld non-sales and use taxation without physical presence did so in cases involving companies that licensed intellectual property for in-state use by related companies, which raised the specter of sham transactions, no business purpose, and other common law doctrines. These cases are distinguishable from the instant situation, which involves no intangible property in Kentucky.

The lower court's decision in this case demonstrates that the departure from the physical presence rule is not limited to those types of cases; it is now being applied to traditional investment relationships. The lower court specifically recognized from the stipulated facts that Petitioners maintained no Kentucky property or employees — their sole connection with Kentucky was the receipt of passive investment income from non-Kentucky entities doing business there. Pet. App. 2a. This notwithstanding, the lower court questioned whether *Quill's* physical presence standard applies in the income tax context, concluding it "is unclear," and ruled that Petitioners' receipt of income from investments in entities with Kentucky operations was sufficient to meet substantial nexus under the Commerce Clause, *merely because the entities [not Petitioners] received protection and benefits from Kentucky*. Pet. App. 11a.

The lower court plainly erred by substituting this Court's Commerce Clause "substantial nexus" standard with the "purposeful availment" standard that defines the Due Process Clause so-called, "minimum contacts." *See Burger King Corp. v. Rudzewicz*, 471 U.S. 462 (1985). As this Court reiterated in *Quill*, the Commerce Clause's limits on state taxation are more restrictive than the "minimum contacts" needed to support personal jurisdiction under the Due Process Clause and are "animated by different constitutional concerns and policies." *Quill*, 504 U.S. at 312-13. As well-reminded in *Quill*, ". . . a corporation may have the 'minimum contacts' with a taxing State as required by the Due Process Clause, and yet lack the 'substantial nexus' with that State as required by the Commerce Clause." *Id.* at 313.

Here, the lower court relied solely upon an erroneous decision from an intermediate appellate court in Illinois holding that out-of-state limited partners are subject to income tax on income received from investments in in-state partnerships, despite having no actual physical presence in Illinois. *See Borden Chemicals and Plastics, LP v. Zehnder*, 726 N.E.2d 73 (Ill. App. 2000). In contrast, however, other state courts in similar fact patterns have held to the contrary. For example, the New Jersey Tax Court recently held in *BIS LP, Inc. v. Dir., Div. of Taxation*, 25 N.J.Tax 88 (N.J. Tax 2009), *appeal docketed*, No. A1172-09 (N.J. Super. Ct. App. Div. Nov. 9, 2009), that an out-of-state limited partner with no physical presence in a state cannot be constitutionally taxed by that state under the Commerce Clause, relying on this Court's decisions in *F.W. Woolworth Co. v. Taxation & Revenue Dep't*, 458 U.S. 354 (1982), and

ASARCO, Inc. v. Idaho State Tax Comm'n, 458 U.S. 307 (1982).

The decision below is one of the most far-reaching departures from the *Quill* physical presence rule to date by a state court, notwithstanding one of the narrowest and purest fact patterns for this Court to consider. If the lower court's decision is left to stand, any out-of-state owner receiving passive investment income from an entity located in a state in which the owner has no physical presence or any physical connection whatsoever, may now be subjected to income taxation jurisdiction by that state. By parity of reasoning, traditional dividend income earned by an out-of-state resident will now be taxable in the distributing state. This is not the law of this Court.

Much has changed in law, society, business, politics and the world during the nearly 20 years since this Court ruled in *Quill* that physical presence in a jurisdiction is a predicate to the constitutional imposition of a state tax. One thing, however, has been and remains constant: the continued disagreement everywhere but at this Court as to the applicability of the principles of *Quill* in state and local taxation. Consequently, this Court should now intervene to resolve these conflicts, foreclose another 20 years of controversy and uncertainty, and re-establish the limits on state taxation under the Commerce Clause as the framers of the Constitution intended.

B. "Modest" Retroactivity – *United States v. Carlton*

A second issue for the Court's consideration involves the retroactive, non-curative tax legislation enacted to the detriment of Petitioners and all other similarly situated taxpayers. In sanctioning this legislation, the lower court ignored the "modesty" requirement of *United States v. Carlton*, 512 U.S. 26 (1994), when analyzing this facially retroactive tax legislation. Justice Blackmun's *Carlton* Opinion, buttressed by the concurring Opinion of Justice O'Connor in *Carlton*, plainly requires a "modesty" analysis. For no other reason than this, the underlying Opinion, simply the latest of many state appellate court decisions to so find, should be reviewed and certiorari granted.

The period of retroactivity *is* a fundamental element to be considered by the judiciary when evaluating retroactive tax legislation; regardless of length, the term must be "modest." The singular point of law arising from *Carlton* traces to the overriding rule that the period of retroactivity must be "modest." As Justice Blackmun wrote for the majority therein, succinctly and plainly, ". . . Second, Congress acted promptly and established only a modest period of retroactivity." *Carlton*, 512 U.S. at 32.

So as to resolve an ever-widening split among the states and bring to a conclusion the plethora of state court litigation and almost continuous retroactive legislating underway, this Court should grant certiorari, hear the dispute, and plainly and unequivocally confirm, 16 years after *Carlton*, that the period of retroactivity in implementing otherwise constitutional, non-curative tax legislation, retroactive on its face, must be "modest."

The concerns of today's citizens as to retrospective tax legislation are the same as those of our founding forefathers in the late 1780s. Today's citizens expect, and in fact are entitled under the Constitution, to be governed by the law of the several states, which, when applied, is sound and fair under the microscope of the Due Process Clause. The national trend on this topic violates these core principles; review by this Court is warranted, necessary and requested.

During the debates leading up to this country's Constitution, the great leaders of our country *specifically addressed* their concern for what they termed "retrospective laws in civil cases." *See* DEBATES IN THE FEDERAL CONVENTION OF 1787 AS REPORTED BY JAMES MADISON, AUG. 28, 1787, H.Doc. No. 398, at 626, 69th Cong. 1st Sess. (1927); *see also* DEBATES IN THE FEDERAL CONVENTION OF 1787 AS REPORTED BY JAMES MADISON, AUG. 29, 1787, H.Doc. No. 398, at 632, 69th Cong. 1st Sess. (1927).[1]

Viewed from our cultural perspective and who we as a people truly are, the scrivener reports of James Madison are most telling — the dilemma faced today, hundreds of years since James Madison recorded such debates, is just as hearty and just as healthy. Now, however, it is time for this Court to once again speak with clarity and authority, and close the debate on this issue.

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1. From a historical perspective, after debate and discussion, the specific reference banning and usurping the power of the states to enact retrospective laws in civil cases was struck, and the ban on legislation impeding contracts took its place. *See generally* U.S. CONST. art. I, § 10.

Retroactive taxation is the very essence of arbitrary action by a legislative body. The arbitrary, and thus punitive, nature of Kentucky's retroactive tax interest statutory changes in question is best demonstrated by briefly reviewing the undisputed facts.

The earliest tax refund at issue was for year 1993 and was filed in 1998; the first Petition of Appeal was filed in 2000 at the Kentucky Board of Tax Appeals ("Board"). After a hearing, the Board ruled in 2006 and ordered a refund payable to Petitioners of approximately $5.1 million, plus interest authorized by law. On first appeal, while reducing the refund award on a substantive issue, the Franklin Circuit Court not only affirmed much of the refund ordered and the interest thereon, but extraordinarily ordered that Kentucky immediately pay the refund. Rather than paying or moving for a Stay of the Order, Respondent appealed.

In conjunction with the Kentucky General Assembly and only weeks after the circuit court Order, Respondent proposed a Bill in 2008, which, on its face, not only changed the interest rate calculus[2] governing the refund within the Judgment in question herein, but also changed the date(s) upon which refund interest commenced to run (*i.e.*, it shortened the number of days of interest *and* reduced the rate of interest). 2008 Ky. Acts. ch. 132 §§ 8, 9, 10, 11, 15.[3]

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2. Moving from a rate driven by the "prime rate" as reported by commercial banks, to a rate of prime rate less 2% on refunds and prime rate plus 2% on assessments.

3. *See also* 2009 Ky. Act. ch. 86 §§ 7, 8, 9, 10 & 15. Pet. App. 87a.

Not to be outdone by the plain text of the changes, the Kentucky General Assembly legislatively pronounced that there: (i) was an "emergency;" (ii) the Bill was effective immediately upon the Governor's signature; and (iii) the text "would govern, control and apply to any claim still pending before . . . the judiciary." Pet. App. 74a-86a. Thus, in one fell swoop, two Orders awarding tax interest to Petitioners were materially reduced, and the law in Kentucky was retroactively rewritten in a manner to statutorily justify same. This arbitrary legislative and executive branch action must stop.

Here, in the face of the facts now before this Court, the question is asked whether a 17 year retroactive change to settled tax law, absent any "curative" need,[4] is *per se* unconstitutional under the Due Process Clause and the *Carlton* "modesty" requirement thereunder.

Hearing the instant case allows the Court to clarify the principles of *Carlton* and its progeny, and provide clarity and much needed bright-lines in a dark and murky area of law. Settled expectations must ripen and mature, for if not now, the question posed becomes — when ever? Certiorari is most appropriate in this case.

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4. The legislative history documents, relied upon by the lower court, confirm this.

STATEMENT OF THE CASE

A. Factual Background

Petitioners' core facts are plain and clear; they have no "physical presence" in Kentucky. All relevant facts applicable to this Petition were stipulated and uncontroverted.

Petitioners maintained no offices, no employees, no places of business and had no real, tangible or intangible property in Kentucky — not even on a transitory basis. All were entities created under the laws of states other than Kentucky (*i.e.*, out-of-state companies); Asworth was a Nevada corporation and HTF and D Aviation were Delaware corporations. All maintained their principal places of business outside of Kentucky.

Petitioners' sole "connection" with Kentucky was that they were partners in two Tennessee-based partnerships that did business in Kentucky (Conwood Company, LP and Conwood Sales Co., LP (collectively "Conwood Companies")). The Conwood Companies were in the business of manufacturing and selling smokeless tobacco. Petitioners had no management, input or other type of control in or over the Conwood Companies, and simply held their interests in Conwood Companies as passive investment interests — Petitioners were pure holding companies. Respondent, Department of Revenue, Finance & Administration Cabinet (f/k/a Revenue Cabinet) is the administrative agency of the Commonwealth of Kentucky, whose responsibility it is to assess and enforce collection of various taxes, including corporation income taxes.

Petitioners filed original Kentucky corporation income tax returns and paid Kentucky corporation income tax calculated by using the standard three-factor apportionment formula of Ky. Rev. Stat. § 141.120, assimilating their individual property, payroll and sales metrics with those from the Conwood Companies to determine the amount of income properly subject to tax by Kentucky.

Respondent undertook a series of audits of Asworth[5] and issued corporation income tax assessments for tax years ending January 31, 1993 through January 31, 1996, contending that it should have apportioned additional income to Kentucky. Asworth disagreed, paid the tax and timely filed amended 1993-1996 returns pursuant to Ky. Rev. Stat. § 134.580, seeking refunds of corporation income tax overpayments on the basis that they had no nexus with Kentucky pursuant to, *inter alia*, the Commerce Clause and Ky. Rev. Stat. § 141.040. Petitioners later filed amended returns for tax years 1997 through 1999 on the same grounds. Respondent denied Petitioners' refund claims and the dispute moved on.

B. Proceedings Below

Petitioners appealed Respondent's denials of their refund claims to the Board. Petitioners contended that they had no physical presence in Kentucky and therefore

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5. HTF and D Aviation were not audited by Respondent nor issued tax assessments.

did not have tax nexus with the state pursuant to, *inter alia*, the Commerce Clause and Kentucky statutory law.[6]

After a hearing on the merits, the Board agreed with Petitioners, finding no tax nexus with Kentucky under Ky. Rev. Stat. § 141.040 because Petitioners did not have any property or employees, and therefore did not have the required physical presence in Kentucky. By ruling on state grounds only, the Board did not reach Petitioners' constitutional assertions. By a January 2006 Order, the Board awarded refunds of all tax overpayments totaling $5.1 million, plus mandatory refund interest pursuant to Ky. Rev. Stat. § 131.183. Pet. App. 47a-50a.

On February 24, 2006, Respondent appealed the Board's Order to the Franklin Circuit Court. In December 2007, the court issued a split decision, holding that Petitioners had tax nexus under Kentucky's statutory scheme, the Commerce Clause and the Due Process Clause, but holding that the proper method of calculation of tax required the use of the three-factor apportionment and assimilation method (based on property, payroll and sales) to determine the amount of tax due to Kentucky. Pet. App. 42a-43a. The Franklin Circuit Court held that Petitioners had nexus, applying *Geoffrey, Inc. v. South Carolina Tax Comm'n*, 437

6. Petitioners also contended that they were not subject to tax under the Due Process Clause, and contended, in the alternative, that if they were subject to corporate income taxation by Kentucky, traditional three-factor apportionment methodology and assimilation of their apportionment factors with those of the Conwood Companies was constitutionally and statutorily required to determine the proper amount of income by Kentucky. These questions are not being put before this Court.

S.E.2d 13 (S.C. 1993), *cert. denied*, 510 U.S. 992 (1993) and *Borden Chemicals and Plastics, LP v. Zehnder*, 726 N.E.2d 73 (Ill. App. 2000). Pet. App. 42a. Because a refund still resulted, the circuit court took the extraordinary step of awarding immediate refunds of tax overpayments, plus refund interest pursuant to the version of Ky. Rev. Stat. § 131.183 in effect at the time. Pet. App. 44a.

On December 17, 2007, Respondent appealed the Order to the Kentucky Court of Appeals regarding the circuit court's findings on apportionment, and did not pay the ordered refund. Petitioners filed a cross-appeal regarding the court's findings on nexus and contended that the Commerce Clause and Due Process Clause prohibited Kentucky's imposition of corporate income tax under the facts before the Court because they did not have physical presence or sufficient minimum contacts in Kentucky. Petitioners subsequently filed an unopposed Motion for Leave to Correct Mathematical Error in Circuit Court's Order and to Allow Parties to Brief Issues Concerning House Bill 704 ("Motion").[7]

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7. House Bill 704 was enacted in 2008 and retroactively amended Ky. Rev. Stat. § 131.183 [the statute relied upon by the Board and the circuit court to award interest to Petitioners], Ky. Rev. Stat. §§ 134.580 and 141.235 to change Kentucky's tax refund scheme to reduce the rate of interest paid on refunds from "prime rate" to "prime less 2%," and the calculation start date, so that interest on any tax refund would no longer be calculated beginning 60 days from the latter of the due date of the return or payment of the tax, but would begin to accrue on the date of the filing of an amended return requesting refunds. As a result, in all cases in which amended returns are filed after the due date of the original return and after the date of payment of the tax [which is nearly always], the amount of interest paid by Respondent on all refund claims, including those at issue here, are decreased. *See* 2008 Ky. Acts. ch. 132 §§ 8, 9, 10, 11 & 15.

Petitioners advised the court regarding another enactment, 2009 House Bill 216, which also retroactively amended the law, similarly to House Bill 704, which directly impacted and reduced the (refund) Judgment of Petitioners. *See* 2009 Ky. Acts. ch. 86 §§ 7, 8, 9, 10 & 15. By Order dated April 24, 2009, the court granted Petitioners' Motion and ordered briefing by the parties regarding all issues concerning House Bills 704 and 216 (collectively, "Bills").

The court ultimately rendered its November 2009 decision, affirming the circuit court's determination that Kentucky had statutory authority to tax Petitioners under Kentucky law and had constitutional authority to tax Petitioners under the Commerce Clause. Notwithstanding an assertion that *Quill's* physical presence rule as applied to income tax cases was "unclear," the court held that physical presence existed for Commerce Clause purposes based on Petitioners' receipt of income from the investment interests held in the Tennessee partnerships doing business in Kentucky. Pet. App. 11a.

The court also took judicial notice of the Bills, rejected Petitioners' contentions that *Carlton's* "modesty" requirement was violated by the severe retroactive nature of the Bills, and held that the Bills did not violate, *inter alia*, the Due Process Clause. As to the retroactive period, the court specifically held that *Carlton* "did not establish . . . a 'modesty requirement;' rather, the majority simply noted with favor that 'Congress acted promptly and established only a modest period of retroactivity.'" Pet. App. 20a.

On December 18, 2009, Petitioners timely filed a Motion for Discretionary Review with the Supreme Court of Kentucky, seeking review of the Court of Appeals' holdings. Petitioners' motion was denied on August 18, 2010.

REASONS FOR GRANTING THE PETITION

I. WITHOUT FURTHER REVIEW, THE KENTUCKY DECISION, WHICH ADDRESSES AN IMPORTANT FEDERAL QUESTION OF COMMERCE CLAUSE NEXUS, WILL STAND IN CONFLICT WITH DECISIONS OF OTHER STATE COURTS

Notwithstanding the Parties' Stipulations that Petitioners had no property or employees in Kentucky, the lower court in this case held through its minimalistic and erroneous analysis of the Commerce Clause that Petitioners had "physical presence" in Kentucky sufficient to subject them to corporate income tax based on Kentucky's protection and benefits provided to two Tennessee-based partnerships and Petitioners' passive investments in those partnerships. Pet. App. 11a.

The lower court's decision is at odds with several cases from sister states and represents the latest of a widening split of authorities. Attached for the Court's review is a map illustrating the split among Kentucky's sister states, representing 9 states following *Quill's* physical presence requirement in non-sales tax cases and 14 states rejecting *Quill* in non sales tax cases.[8] Pet.

8. Also attached is a Table of Authorities referenced in the map. Pet. App. 121a.

App. 120a. Further, at least 35 states have enacted legislation, regulations or policies specifically rejecting the physical presence test in income tax settings and stating that holding partnership interests alone creates tax nexus, again contrary to this Court's holding in *Quill*.[9]

The lower court below erroneously relied upon *Borden Chemicals and Plastics, LP v. Zehnder*, 726 N.E.2d 73 (Ill. App. 2000) (holding that limited partner had physical presence in Illinois for Commerce Clause purposes). However, the Illinois court's decision stands in stark contrast to the New Jersey Tax Court's decision in *BIS LP, Inc. v. Dir., Div. of Taxation*, 25 N.J. Tax 88 (N.J. Tax 2009), *appeal docketed*, No. A1172-09 (N.J. Super. Ct. App. Div. Nov. 9, 2009). In *BIS*, the court held that BIS, as a passive investor in a partnership with New Jersey operations, was not subject to New Jersey corporation business tax. *Id.* (citing *F.W. Woolworth Co.* and *ASARCO, Inc., supra*).[10]

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9. *See* 2010 SURVEY OF STATE TAX DEPARTMENTS, pp. 20-22; 42-43 (BNA State Tax ed., BNA) (2010); *See*, e.g., Ky. Rev. Stat. § 141.040 (effective 2005); Conn. Gen. Stat. § 12-214(a)(3); Iowa Code § 422.33(1); S.C. Code Ann. 12-6-530; Wis. Stat. § 71.23(2).

10. The lower court's decision in this case is also contrary to the Alabama state court's decision in *Lanzi v. Alabama Dep't of Revenue*, 968 So.2d 18 (Ala. App. 2006) (nonresident limited partner was not subject to Alabama income taxes under the Due Process Clause; Commerce Clause argument not reached by the court) and the Supreme Court of Missouri's decision in *Acme Royalty Co. v. Dir. of Revenue*, 96 S.W.3d 72 (Mo. 2002). Further, many lower courts and administrative tribunals have also considered, and are continuing to consider, this issue. *See Cerro Copper Prod., Inc. v. Alabama Dep't of Revenue*, No. F. 94-444, 1995 WL 800114 (Ala. Dep't of Revenue, Admin. Law Div.

(Cont'd)

The lower court's decision is also squarely at odds with the Texas Court of Appeals' decision in *Rylander v. Bandag Licensing Corp.*, 18 S.W.3d 296 (Tex. App. 2000). *Rylander* upheld *Quill's* physical presence rule and held that Texas could not impose the state's franchise tax, a tax on the privilege of doing business in the state, on an out-of-state corporation that did not have a physical presence; *i.e.*, meaning property or employees, in Texas. *See also Midland Cent. Appraisal Dist. v. BP America Prod. Co.*, 282 S.W.3d 215, 224 (Tex. App. 2009); *Peoples Gas, Light, and Coke Co. v. Harrison Cent. Appraisal Dist.*, 270 S.W.3d 208 (Tex. App. 2008). *But see INOVA Diagnostics, Inc. v. Strayhorn*, 166 S.W.3d 394, 402 (Tex. App. 2005), *cert. denied*, 547 U.S. 1072 (2006).

The lower court's decision is also contrary to the Tennessee Court of Appeals' published holding in *J.C. Penney Nat'l Bank v. Johnson*, 19 S.W.3d 831 (Tenn. App. 1999), *cert. denied*, 531 U.S. 927 (2000). The court in *J.C. Penney* held that Tennessee could not constitutionally tax the corporate earnings of non-resident corporations that had no physical presence, again, referring to real or tangible property or employees, in Tennessee. The court explained that no valid distinction could be made for Commerce Clause purposes between income-based taxes and sales and use taxes.[11]

(Cont'd)

Dec. 11, 1995; *see also In the Matter of the Petition of Wascana Energy Mktg. (U.S.), Inc.*, DTA No. 817866, 2002 WL 1726832 (N.Y. Div. of Tax App. Aug. 8, 2002) (Advisory Opinion).

11. *But see America Online, Inc. v. Johnson*, No. M2001-00927-COA-R3-CV, 2002 WL 1751434 (Tenn. App. Jul. 30, 2002) (not officially published and not citable in Tennessee).

The lower court's decision is also in conflict with the Michigan Court of Appeals' decisions in *Guardian Indus. Corp. v. Dep't of Treasury*, 499 N.W.2d 349 (Mich. App. 1993) and *Gillette Co. v. Dep't of Treasury*, 497 N.W.2d 595 (Mich. App. 1993), *cert. denied*, 513 U.S. 1103 (1995). Those decisions applied *Quill's* physical presence rule, requiring the existence of real or tangible property or employees, before imposition of Michigan's "single business tax."

Expressly contrary to *Quill* and the state court decisions applying its physical presence rule, some state appellate courts have held that physical presence is limited to sales and use taxes, and that the Commerce Clause authorizes taxation of non-resident out-of-state companies having no physical presence in a state. This traces to *Geoffrey, Inc. v. South Carolina Tax Comm'n*, 437 S.E.2d 13, 18 (S.C. 1993), *cert. denied*, 510 U.S. 992 (1993), where the court held that the physical presence rule set forth in *Quill* "had not been extended to other types of taxes," and held that "by licensing intangibles for use in [South Carolina]" by its affiliates, the Delaware corporation had a "substantial nexus" with South Carolina. *Id.* at 18 & n.4.

Several other state appellate courts followed South Carolina's lead, including *Couchot v. State Lottery Comm'n*, 659 N.E.2d 1225, 1230 (Ohio 1996), *cert. denied*, 519 U.S. 810 (1996) ("[t]here is no indication in *Quill* that the Supreme Court will extend the physical-presence requirement to cases involving taxation measured by income derived from the state."); *Buehner Block Co. v. Wyoming Dep't of Revenue*, 139 P.3d 1150, 1158 n.6 (Wyo. 2006) ("*Bellas Hess* and *Quill* have

created the specialized jurisprudence . . . applicable to 'sales or use tax case[s]'"). *See also Kmart Properties, Inc. v. Taxation & Revenue Dep't of the State of New Mexico*, 131 P.3d 27, 35 (N.M. App. 2001), *writ quashed*, 131 P.3d 22, 35-36 (N.M. 2005); *Comptroller of the Treasury v. SYL, Inc.*, 825 A.2d 399, 415-416 (Md. 2003), *cert. denied*, 540 U.S. 984 (2003).

The ever growing judicial split is well known and acknowledged by state courts. *See Bridges v. Geoffrey, Inc.*, 984 So.2d 115, 127 (La. App. 2008), *writ denied*, 978 So.2d 370 (2008) (rejecting *Quill's* physical presence requirement and describing *J.C. Penney* and *Rylander* as not "persuasive"); *Geoffrey, Inc. v. Oklahoma Tax Comm'n*, 132 P.3d 632 (Okla. App. 2005), *cert. denied* (2006) (rejecting *Quill's* physical presence requirement and attempting to distinguish *J.C. Penney* and *Rylander*); *A & F Trademark, Inc. v. Tolson*, 605 S.E.2d 187, 196 n.9 (N.C. App. 2004), *cert. denied*, 546 U.S. 821 (2005) (rejecting *Quill's* physical presence requirement and attempting to distinguish *J.C. Penney*); *Gen. Motors Corp. v. City of Seattle*, 25 P.3d 1022, 1028 (Wash. App. 2001), *cert. denied*, 535 U.S. 1056 (2002) (rejecting physical presence standard and noting that the taxpayers "correctly argue that some state courts have extended the physical presence rule.").

The New Jersey and West Virginia Supreme Courts have specifically faced the split of states regarding the application of *Quill*. *See Lanco, Inc. v. Dir., Div. of Taxation*, 908 A.2d 176, 177 (N.J. 2006), *cert. denied*, 551 U.S. 1131 (2007) ("[s]ince the Court decided *Quill*, a split of authority has developed regarding whether the Supreme Court's holding was limited to sales and

use taxes."). *See Tax Com'r of State v. MBNA America Bank, N.A.*, 640 S.E.2d 226, 231 (W.Va. 2006), *cert. denied*, 551 U.S. 1141 (2007) (stating that the issue of whether *Quill* applies to income and franchise taxes was a "major question left open by the Supreme Court's opinion."[12]; *see also Capital One Bank v. Com'r of Revenue*, 899 N.E.2d 76 (Mass. 2009), *cert. denied*, 129 S.Ct. 2827 (U.S. 2009); *Geoffrey, Inc. v. Com'r of Revenue*, 899 N.E.2d 87 (Mass. 2009), *cert. denied*, 129 S.Ct. 2853 (U.S. 2009).

The lower court endorsed a broad assertion of extraterritorial taxation power, disregarded well-reasoned court decisions and concluded that Kentucky could tax an investor receiving investment income from a separate and distinct entity operating in Kentucky for the sole reason that the in-state entity was receiving Kentucky's "protection and benefits." The lower court's decision thus brings the post-*Quill* chaotic state of affairs full circle, beginning with South Carolina's *Geoffrey* decision holding that physical presence was not needed for taxation for out-of-state companies in the context of intangible holding companies, through the lower court's holding that a state may tax an out-of-state company even where there is no intangible property in the state but merely receives distributive income from a business receiving "protection and benefits" from Kentucky.

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12. *See also Chase Manhattan Bank v. Gavin*, 733 A.2d 782 (Conn. 1999), *cert. denied*, 528 U.S. 965 (1999) (noting that *Quill* was not limited to sales and use tax related disputes, although it ultimately concluded that there was no Commerce Clause violation).

This pervasive ongoing split of authority among the lower courts constitutes substantial reason for this Court to grant review of this important case, and certiorari is warranted.

II. WITHOUT FURTHER REVIEW, THE KENTUCKY DECISION WILL EFFECTIVELY OBLITERATE THE PHYSICAL PRESENCE TEST SET FORTH IN *QUILL* AND SUBSTITUTE A "METAPHYSICAL" PRESENCE TEST

"The very purpose of the Commerce Clause [is] to ensure a national economy free from . . . unjustifiable local entanglements." *Nat'l Bellas Hess v. Dep't of Revenue of Illinois*, 386 U.S. 753, 760 (1967). This Court's decision noted the distinction between constitutional taxation of companies with property or employees in a state and unconstitutional taxation of companies with no property or employees in a state. *Id.* at 758. "[T]his basic distinction," this Court observed, "until now has been generally recognized by the state taxing authorities," and "is a valid one." *Id.* This Court therefore held that it "decline[d] to obliterate it." *Id.*

Later, this Court reaffirmed the physical presence standard and set forth a four-part test for proper state taxation under the Commerce Clause in *Complete Auto Transit v. Brady*, 430 U.S. 274 (1977). *Complete Auto* held that to satisfy the constitutional prerequisites, a tax: (1) must be "applied to an activity with a *substantial nexus* with the taxing state;" (2) must be "fairly apportioned;" (3) must "not discriminate against interstate commerce;" and (4) must be "fairly related to the services provided by the state." *Id.* at 279 (emphasis

added). *See also Barclays Bank PLC v. Franchise Tax Bd. of California*, 512 U.S. 298, 310-311 (1994) (reaffirming *Complete Auto* standard).

In *Quill*, this Court plainly reaffirmed and highlighted the viability of the physical presence rule and noted that its holding was not limited to sales and use taxes. This Court observed:

> we have never intimated a desire to reject an established "bright-line" test. Although we have not, in our review of other types of taxes, articulated the same physical-presence requirement that *Bellas Hess* established for sales and use taxes, that silence does *not* imply repudiation of the *Bellas Hess* rule.

Quill, 504 U.S. at 314 (emphasis added). This Court went on to hold that ". . . the bright-line rule of *Bellas Hess* furthers the ends of the dormant Commerce Clause." *Id.* Accordingly, this Court specifically held that "substantial nexus" between a taxing State and an out-of-state corporation is met only where the corporation has a "physical presence" in the taxing state. *Id.*

Moreover, this Court recognized in *Quill* that the bright-line rule articulated in *National Bellas Hess* "furthers the ends of the dormant Commerce Clause" and it "encourages settled expectations and, in doing so, fosters investment by businesses and individuals." *Id.* at 314-16. It is critical to note that this Court, as explained in *Quill*, has *never* found "substantial nexus" in the absence of physical presence in matters brought before it. Further, this Court has never suggested that

the meaning of "substantial nexus" varies depending on the type of tax involved. As Professor Pomp opined below in the Board hearing in this matter: "The Constitution does not distinguish between sales and use taxes and income taxes: there is only one nexus standard and the U.S. Supreme Court has endorsed physical presence." Pet. App. 114a. There is only one Constitution after all.

Such a shifting test, one requiring physical presence in sales and use tax cases while allowing "metaphysical presence" in income tax cases, would create unconscionable results. Indeed, this Court has applied "substantial nexus" principles arising from sales and use tax cases to disputes involving other types of state taxes. *See Tyler Pipe Indus., Inc. v. Washington State Dep't of Revenue*, 483 U.S. 232 (1987), *cert. denied*, 486 U.S. 1040 (1988). *Tyler Pipe* relied on *Scripto, Inc. v. Carson*, 362 U.S. 207 (1960), involving use tax issues, to determine if a taxpayer had substantial nexus with a state that subjected it to a business tax.

As this Court specifically held in *Quill*, 504 U.S. 298, 315 at n.8, a "slightest presence" or "minimal nexus" is *not* sufficient to establish nexus under the Commerce Clause. Indeed, as Justice White pointed out in *Quill*, "reasonable minds surely can, and will, differ over what showing is required to make out a 'physical presence' adequate to justify imposing responsibilities for use tax collection." *Quill*, 504 U.S. at 330, 331 (concurring in part and dissenting in part). Petitioners' passive investment holdings in Tennessee entities having Kentucky operations simply cannot as a matter of law rise to the level of "substantial nexus" under this Court's previous decisions and standing precedent.

In contrast, the lower court erred and juxtaposed Commerce Clause "substantial nexus" with the "purposeful availment" standard that defines "minimum contacts" under Due Process. *See Burger King Corp. v. Rudzewicz*, 471 U.S. 462, 775 (1985). Contrary to the lower court's decision, whether Petitioners receive "protection and benefits" from Kentucky is not the correct question to ask in a Commerce Clause analysis.

As this Court explained in *Quill*, the Commerce Clause and the Due Process Clause reflect very different concerns and thus use very different analyses:

> Due Process centrally concerns the fundamental fairness of governmental activity. Thus, at the most general level, the due process nexus analysis requires that we ask whether an individual's connections with a state are substantial enough to legitimate the state's exercise of power over him. We have, therefore, often identified "notice" or "fair warning" as the analytic touchstone of due process nexus analysis. In contrast, the Commerce Clause and its nexus requirement are informed not so much by concerns about fairness for the individual defendant as by structural concerns about the effects of state regulation on the national economy.

Quill, 298 U.S. at 312.

This Court has held that "... a corporation may have the 'minimum contacts' with a taxing State as required by the Due Process Clause, and yet lack the 'substantial nexus' with that State as required by the Commerce

Clause." *Quill*, 298 U.S. at 313. The lower court's substitution of due process "protection and benefits" for the Commerce Clause's requirement of "physical presence" "substantial nexus" per *Quill* was grave error, one of nation-wide consequence that materially harms and furthers the conflicts presented.

As Professor Pomp opined in this case:

> [B]y any principled measure of comparison, physical presence is to be preferred to metaphysical presence as a nexus standard. Physical presence is more consistent with a bright line test, more consistent with settled expectations, more likely to reduce litigation and foster interstate investment, less likely to discriminate against the service sector, less likely to lead to multiple taxation, more easily administered, and more compatible with the growth of electronic commerce.
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> * * *
>
> [M]etaphysical presence is less a legal principle and more an invitation to chaos and multiple taxation, thus undercutting the very goals of the commerce clause that the concept of nexus is intended to further.

Pet. App. 114a.

Petitioners have absolutely *no* physical presence in Kentucky, as stipulated to by Respondent — no real, tangible or intangible property, no office and no employees located in Kentucky. Boiled down, the lower court's decision held that Petitioners have "metaphysical

presence," as coined by Professor Pomp, and therefore "minimal nexus" in Kentucky — merely because Kentucky provided "protection and benefits" to two Tennessee-based entities in which Petitioners held passive investments from which they received income.

Under the lower court's reasoning, *all* companies will now be subject to state taxation so long as they receive income from an in-state company receiving "protection and benefits" from that state, presumably resulting in the taxation of, *inter alia*, passive dividend income of non-residents. As Professor Pomp opined below:

> An out-of-state corporate partner that is a passive investor in a partnership should be treated the same as an out-of-state shareholder in a corporation. Such a partner should be viewed as separate from the partnership just the way a shareholder is viewed as separate from a corporation. The activities of a traditional corporation are not attributed to its shareholders; similarly, the activities of the partnership should generally not be attributed to its partners. Consequently, an out-of-state partner that has no property or payroll of its own in Kentucky should not be viewed as having nexus with Kentucky just because the partnership has property or payroll in the State.

Pet. App. 119a. The lower court's flawed substitution of Due Process Clause analysis for Commerce Clause analysis is material, harmful and should be reviewed by this Court. Certiorari is warranted.

III. WITHOUT FURTHER REVIEW, THE LOWER COURT'S DECISION EVISCERATES THE "MODESTY" REQUIREMENT OF *CARLTON*, AND FURTHERS A SPLIT ON THE CONSTITUTIONAL STANDARDS TO GOVERN RETROACTIVE TAX LEGISLATION

In *United States v. Carlton*, 512 U.S. 26 (1994), with Justice Blackmun writing for a unanimous Court on the merits, this Court was clear that for retrospective amending legislation not to run afoul of the Due Process Clause, the involved Act must ". . . establish[ ] only a modest period of retroactivity." *Id.* at 32. If for no other reason than to bring to a conclusion the plethora of *Carlton*-related litigation, literally from all across the country,[13] this Court should grant certiorari and hear the dispute so as to plainly and unequivocally state that the period of retroactivity when implementing non-curative tax legislation made retroactive on its face must be "modest."

Carlton was hoped to be a solution to the retroactive tax legislation issue. However, far from avoiding or resolving disputes, many state court jurists see this constitutional predicate as *dicta*; others simply ignore it. The modesty requirement set forth in *Carlton* lead Justices Scalia and Thomas to aptly predict:

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13. *See Triple-S Mgmt., Corp. v. Mun. Revenue Collection Ctr.*, 130 S.Ct. 3498 (U.S. 2010) (involving an appeal to the Supreme Court of the Commonwealth of Puerto Rico concerning a period of retroactivity beyond 15 years).

> The reasoning the Court applies to uphold the statute in this case guarantees that *all* retroactive tax laws will henceforth be valid.

Id. at 40 (Scalia & Thomas, JJ., concurring) (emphasis in original).

Hearing the instant case affords the Court an opportunity to clarify *Carlton* and its progeny, and to offer bright-lines to ever growing competing lines of authorities and resolve an ever-widening split across the nation.

A. The Courts Of Kentucky And Other States Are Rejecting The Premise That *Carlton* Requires A "Modest" Period Of Retrospective Application

Over the past 16 years, dozens of cases across the country have addressed what has come to be known as the *Carlton* "modesty analysis." *See, e.g., Miller v. Johnson Controls, Inc.*, 296 S.W.3d 392, 399-400 (Ky. 2009), *cert. denied*, 130 S.Ct. 3324 (U.S. 2010). Some commentators and courts assert that as a matter of law, no "modesty" predicate underlies this Court's *Carlton* Due Process analysis. Quite the contrary, Justice Blackmun's words are clear, concise, and unequivocal — he could not have used fewer words.

Case law, some applying a *Carlton*-like modesty test and some not, is varied and diverse across the nation. The breadth of the split is apparent. In *Estate of Edward Kunze v. Com'r of Internal Revenue*, 233 F.3d 948, 954 (7th Cir. 2000), for example, the court relied on

Carlton's "modesty" requirement in upholding a statute with an eleven-month retroactivity period. *See also, e.g.*, *Kitt v. United States*, 277 F.3d 1330, 1334-35 (Fed. Cir. 2002) (seven-month period); *Quarty v. United States*, 170 F.3d 961, 965-68 (9th Cir. 1999) (eight-month period); *Kane v. United States*, 942 F.Supp. 233, 234 (E.D. Pa. 1996) (eight-month period); *Gardens at W. Maui Vacation Club v. County of Maui*, 978 P.2d 772, 782-83 (Haw. 1999) (six-month period); *cf. Jefferson County Comm'n v. Edwards*, --- So.3d ---, 2010 WL 1946274, at *4, *9 (Ala. May 14, 2010) (citing *Carlton* as requiring a "modest" retroactivity period).

Still further, in *Montana Rail Link v. United States*, 76 F.3d 991 (9th Cir. 1996), the Ninth Circuit held that a shorter period of retroactivity would have been arbitrary, yet it did not specifically address the "modesty" issue. *Id.* at 993-994. *Enter. Leasing Co. of Phoenix v. Arizona Dep't of Revenue*, 211 P.3d 1 (Ariz. App. 2008), advocated leeway for retroactivity beyond one year when a legislature acts promptly. *Enterprise Leasing*, 211 P.3d at 6 (upholding a six-year retroactive period). An Alabama Court has found a two to three-year period "modest" in *Monroe v. Valhalla Cemetery Company, Inc.*, 749 So.2d 470, 474-475 (Ala. App. 1999), *cert. denied*, 529 U.S. 1022 (2000). A New York court has emphasized the need for flexibility when retroactive tax legislation is implemented in response to a federal constitutional infraction, and, in so holding, did not even mention or cite to *Carlton*. *See Moran Towing Corp. v. Urbach*, 1 A.D.3d 722, 724-725, 768 (N.Y.A.D. 2003). And in *Miller*, Kentucky's highest court stressed that what is modest depends on the circumstances and facts of the case, and disregarded the modesty test as an

overriding element. *Miller v. Johnson Controls, Inc.*, *supra*.[14]

Over only the last few months it has been demonstrated, once again, that the split continues. *See Zaber v. City of Dubuque*, --- N.W.2d ---, 2010 WL 2218625 (Iowa 2010) (five-year retroactive new tax was upheld; emphasis on "curative" nature used); *Ford Motor Credit Co. v. Michigan Dep't of Treasury*, No. 289781 (Mich. App. Jan. 12, 2010) (unreported), *petition for cert. filed*, (U.S. Oct. 12, 2010) (No. 10-481). (retroactive legislation abrogating a tax refund sanctioned).

Recognizing the ongoing rift as to the breadth and scope of *Carlton*,[15] in conjunction with the ongoing events in Congress concerning dozens of expiring (or expired) tax changes, this Court and countless others undoubtedly face yet another round of upcoming litigation concerning retroactive legislation without intervention by this Court.

14. Still other courts have opined on *Carlton* and its modesty provisions. *See Rivers v. State*, 490 S.E.2d 261, 277-79 (S.C. 1997) (holding two to three-year period not modest); *City of Modesto v. Nat'l Med. Inc.*, 27 Cal.Rptr.3d 215, 222 (Ca. App. 2005); *Buerer v. United States*, 141 F.Supp.2d 611, 614 (W.D.N.C. 2001) (minimizing the importance of the *Carlton* "modesty" text).

15. Commentators have written extensively on the topic of retroactive tax legislation; the progression is worthy of review. *See* Frederick A. Ballard, *Retroactive Federal Taxation*, 48 Harv. L. Rev. 592 (1935); Charles B. Hochman, The Supreme Court and the Constitutionality of Retroactive Legislation, 73 Harv. L. Rev. 692 (1960); Faith Colson, *The Supreme Court Sounds the Death Knell for Due Process Challenges to Retroactive Tax Legislation*, 27 Rutgers L.J. 243 (1995) and the authorities therein.

The period of retroactivity *is* a fundamental element to be considered by the judiciary when evaluating retroactive tax legislation; regardless of length, it must be "modest." The plain rejection of the *Carlton* modesty requirement by the lower court and the Kentucky Supreme Court in *Miller, supra*, demonstrates the need for this Court's intervention herein — *but for* clarity on this issue by way of granting certiorari herein, the prescient words of Justices Scalia and Thomas will continue to ring true. *See Carlton*, 512 U.S. at 39-42 (Scalia & Thomas, JJ., concurring).

This Court's progression of closely analyzing retrospective tax legislation is long and deep. *See, e.g., Untermyer v. Anderson*, 276 U.S. 440 (1928); *Cooper v. United States*, 280 U.S. 409 (1930); *Milliken v. United States*, 283 U.S. 15 (1931); *United States v. Hudson*, 299 U.S. 498 (1937); *Welch v. Henry*, 305 U.S. 134 (1938); *United States v. Darusmont*, 449 U.S. 292 (1981); *Pension Benefit Guar. Corp. v. R.A. Gray & Co.*, 467 U.S. 717 (1984); *United States v. Hemme*, 476 U.S. 558 (1986). While the facts certainly change from circumstance to circumstance, the scrutiny applied remains true under *Carlton*.

These cases and their holdings notwithstanding, as Justice O'Connor plainly noted in her concurrence in *Carlton*:

> In every case in which we have upheld a retroactive federal tax statute against due process challenge, however, the law applied retroactivity for only a relatively short period prior to enactment.

Carlton, 512 U.S. 26, 38 (O'Connor, J. concurring).

In contrast, the lower Kentucky court herein interpreted *Carlton* in a completely different manner and from a wholly different paradigm:

> The Corporations also contend that the four-year period[16] of retroactivity in this case fails to meet the "modesty requirement" of retroactive tax legislation under *Carlton*. However, contrary to the Corporations' assertion, the holding in *Carlton* did not establish such a "modesty requirement;" rather, the majority simply noted with favor that "Congress acted properly and established only a modest period of retroactivity."

Pet. App. 20a.

Certiorari is respectfully requested so that the Court may review the 17-year retrospective period called into question because of the Bills, and clarify the law so as to fill in the monumental divide across the country on the meaning and import of *Carlton's* "modesty" requirement.

B. When Retrospective Legislation Is "Non-Curative" In Nature, Due Process Should Require More, Not Less, "Modesty" For The Period Involved

Congress has for generations seen fit to enact curative legislation, so-called as it is designed to "fix an

16. This finding is flawed, in that, applied to Petitioners, the facial retrospective period approaches 17 years.

ill" or "cure an evil." The cases suggest that legislation designed to cure drafting errors in the drafting of tax legislation, and to close "loopholes" created in the legislative process, is an appropriate subject for retroactive treatment. *See, e.g., Graham & Foster v. Goodcell*, 282 U.S. 409, 428 (1931) (stating that the power to enact curative statutes is unequivocally valid). This concept, too, seemingly applies to legislation designed to thwart circumstances of tax evasion. In *Untermyer, supra*, Justice Brandeis highlighted that the retroactive features of the challenged statute had "a special justification" because they were designed to prevent evasion of the tax. *Id.* at 450.

Alas, the *Carlton* case involved just such a curative legislative situation — an effort by Congress to correct what it asserted were unintentionally enacted "loopholes." In its starkest terms, a circumstance where Congress originally projected a tax break of $300 million, was in hindsight of mere months revised and projected at $7 billion — clearly a legislative effort to address the oft-referred to "law of unintended consequences." Designed to retroactively remedy what it saw and publicly asserted was a "patent abuse," Congress' Act at question in *Carlton* does in fact represent a rational method accompanying a legitimate governmental purpose when seen as the curative legislation it was.[17]

17. As to the "curative" nature thereof, *see* Briefs of Petitioner, United States of America, *United States v. Carlton*, 512 U.S. 26 (1994), reprinted at 1993 WL 638225 (U.S.), Reply Brief of Petitioner, United States of America, *United States v. Carlton*, 512 U.S. 26 (1994), reprinted at 1993 WL 13010930 (U.S.), making it clear that the Petitioner, United States, saw the case as only involving a curative-tax amendment designed to plug a loophole.

To state the obvious, retroactivity is disfavored under fundamental notions of justice. *Eastern Enterprises v. Apfel*, 524 U.S. 498, 532 (1998).[18] Accordingly, this Court has observed that "statutory retroactivity has long been disfavored" [*Landgray v. U.S.I. Film Prods.*, 511 U.S. 244, 268 (1994)], curative amendments being an exception. The Bills in question herein were not "curative," there was no fiscal crisis and accordingly there is no appropriate justification to override the modesty predicate of *Carlton*.

Retrospective amendments are in some instances a violation of the fundamental fairness citizens demand; no less than the credibility of our government is at stake. Trust in government is fundamental and axiomatic in a country of laws, not men. *See St. Regis Paper Co. v. United States*, 368 U.S. 208, 209 (1961) (Black, J., dissenting) ("It is no less good morals and good law that the Government should turn square corners in dealing with their Government."); *Federal Crop Ins. Corp. v. Merrill*, 332 U.S. 380, 387-88 (1947) (Jackson, J., dissenting) ("It is very well to say that those who deal with the Government should turn square corners. But there is no reason why the square corners should constitute a one-way street").

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18. *See also Harper v. Virginia Dep't of Taxation*, 509 U.S. 86 (1993) (Scalia, J., concurring) (noting that "original and enduring American perception of the judicial role sprang . . . from the jurisprudence of Blackstone, which viewed retroactivity as an inherent characteristic of the judicial power, a power 'not delegated to pronounce a new law, but to maintain and expound the old one.'") (quoting 1 W. Blackstone, *Commentaries* *69 (1765)).

The concerns today as to retrospective tax legislation are the same as that of our forefathers over 200 years ago when debating the Constitution. Clarity is needed. While we know that a 30 to 50-year period of retroactivity "is far from outside the bounds of retroactivity permissible" under due process analysis [*Eastern Enterprises v. Apfel*, 524 U.S. 498, 550 (1998)], the question remains, what period of retroactivity is not "modest?" Only certiorari will appropriately address this issue.

CONCLUSION

For the foregoing reasons, the Petition for Writ of Certiorari should be granted.

Respectfully submitted,

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APPENDIX

APPENDIX A — OPINION AFFIRMING IN PART, REVERSING IN PART, AND REMANDING, COMMONWEALTH OF KENTUCKY COURT OF APPEALS DATED NOVEMBER 20, 2009

COMMONWEALTH OF KENTUCKY
COURT OF APPEALS

NO. 2007-CA-002549-MR
AND
NO. 2008-CA-000023-MR

APPEAL AND CROSS-APPEAL FROM
FRANKLIN CIRCUIT COURT
HONORABLE THOMAS D. WINGATE, JUDGE
ACTION NO. 06-CI-00288

REVENUE CABINET (N/K/A FINANCE AND ADMINISTRATION CABINET, DEPARTMENT OF REVENUE), COMMONWEALTH OF KENTUCKY

APPELLANT/CROSS-APPELLEE

V.

ASHWORTH CORPORATION (N/K/A ASHWORTH, LLC), HT-FORUM, INC. (N/K/A HTF, LLC); AND D AVIATION SERVICES, INC. (N/K/A D AVIATION SERVICES, LLC

APPELLEES/CROSS-APPELLANTS

OPINION
AFFIRMING IN PART, REVERSING IN PART, AND REMANDING

* * * * * * * * * *

Appendix A

BEFORE: CLAYTON, NICKELL, AND VANMETER, JUDGES.

VANMETER, JUDGE: The Revenue Cabinet, Commonwealth of Kentucky (n/k/a Finance and Administration Cabinet, Department of Revenue) (the Cabinet) appeals from the Franklin Circuit Court's order reversing the order of the Kentucky Board of Tax Appeals (Board). Asworth Corporation (n/k/a Asworth, LLC), D Aviation Services, Inc. (n/k/a D Aviation Services, LLC), and HT-Forum, Inc. (n/k/a HTF, LLC), (collectively the Corporations) cross-appeal from the same order. For the following reasons, we affirm the circuit court's order to the extent that it held that the Corporations have a tax nexus with Kentucky. We reverse insofar as it applied the three-factor apportionment method and ordered an immediate refund.

While this matter was pending before the Board, the parties stipulated to, *inter alia*, the following facts.[1] The Corporations were created under the laws of either Nevada or Delaware, all with their principal places of business in Chicago, Illinois. The Corporations "manage investments in various legal entities." None of the Corporations had any property, employees, or payroll in Kentucky during the tax years at issue. Nor have the Corporations ever been domiciled in Kentucky. Their sole connection with Kentucky was their "receipt of a distributive share of partnership income received from

1. We quote at times from the parties' stipulations.

the profits of variously named and organized partnerships doing business in Kentucky." Board Order at 2.

1993-1996

For the taxable periods ending on January 31 of 1993, 1994, 1995, and 1996, "Asworth filed Kentucky corporation income tax returns . . . and paid Kentucky corporate income tax calculated by using the standard three-factor apportionment formula (property, payroll, and receipts) under KRS[2] 141.120 to apportion its multistate income to Kentucky, and included the property, payroll and receipts of" both Asworth and Conwood Company, LP, a Delaware limited partnership of which Asworth owned a 99% limited partnership interest. Conwood is a Delaware limited partnership which has its principal place of business in Tennessee, and which also conducts business in Kentucky. "Asworth also filed Kentucky corporation license tax returns and paid the Kentucky corporate license tax of KRS 136.070 using the same methodology it utilized for corporate income tax for" these tax years.

Based on its audit of Asworth for these tax years, the Cabinet concluded that although Asworth was not required to file a corporation license tax return, it owed additional taxes, plus applicable interest and penalties. The Cabinet excluded Asworth's receipts and all of its affiliated entities in assessing the additional taxes,

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2. Kentucky Revised Statutes.

including "only Conwood receipts in Kentucky [presented in the formula] over Conwood receipts everywhere in the calculation(s)." That is, the Cabinet utilized a single-factor apportionment formula.

Asworth paid the taxes as assessed by the Cabinet, and then filed amended returns requesting a refund for the taxes it paid in relation to its original returns, as well as the increased amount it paid in relation to the Cabinet's audit assessment, plus the applicable interest and penalties. Asworth argued "that it had no nexus with Kentucky under KRS Chapter 141, and therefore was not subject to corporate income tax." The Cabinet denied Asworth's request for a refund, and Asworth appealed to the Board.

1997-1999

For the taxable periods ending January 31, 1997, and December 31 of 1997, 1998, and 1999, the Corporations each filed Kentucky corporation income tax returns and paid Kentucky corporation income tax. Through various corporate structure changes and transfers not pertinent here, at some point D Aviation Services and HT-Forum acquired ownership interests in Conwood.

Thereafter, the Corporations filed amended returns requesting refunds for the sums they paid for these taxable periods, plus interest. The Corporations argued that they did not have any tax liability in Kentucky. The

Cabinet denied the requests for refunds,[3] and the matters were eventually appealed to the Board.

Procedural Posture

On appeal to the Board, the Corporations' appeals were consolidated pursuant to a motion which indicated that the appeals concerned the same issues, related to the same tax, and involved related entities. Ultimately, the Board held that "KRS 141.040 did not reach the distributive share paid to [the Corporations] by partnerships doing business in the Commonwealth" since they did not own property, lease property, or have any employees receiving compensation in Kentucky. Thus, the Corporations did not have a "physical presence" in Kentucky and were not subject to Kentucky corporation income tax.

On appeal, the circuit court reversed, holding that the Corporations were "subject to tax on their distributive share income from partnerships doing business both within and without Kentucky pursuant to KRS 141.206." The circuit court calculated the amount owed based upon the ratio of sales, property, and payroll in Kentucky to total sales, property, and payroll everywhere in the United States (the three-factor method). This appeal and cross-appeal followed.

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3. While the Cabinet never ruled on Asworth's claim regarding any refund for the taxable period ending January 31, 1997, the parties agree that the outcome here will also apply to that claim.

Following oral argument on the merits of the case, the Corporations moved for leave to correct a mathematical error in the circuit court's order and to allow the parties to brief issues concerning 2008 Regular Session House Bill (H.B.) 704 or to remand the case to the circuit court for review of H.B. 704. The Cabinet, in response, stated that it did not oppose the motion. Thereafter, this court granted the Corporations' motion, ordering a mathematical revision of the circuit court's order entered December 4, 2007, taking judicial notice of the enactment of 2008 Ky. Acts, c. 132 § 8 (*repealed and reenacted* by H.B. 216, 2009 Gen. Assem., Reg. Sess. (Ky. 2009) (enacted)), (collectively the Bills), and granting leave for the parties to brief issues concerning the Bills. These issues will be addressed following our discussion of the circuit court's order reversing the order of the Board.

Whether Statutes Require Taxation

First, the Corporations argue on cross-appeal that the circuit court erred by finding that the Corporations are subject to taxation pursuant to KRS 141.206(5). We disagree.

KRS 141.040(1) provides[4] that with certain exceptions, the following shall pay for each taxable year a tax on taxable net income: "every foreign corporation owning or leasing property located in this state or

4. Unless otherwise noted, we quote from the statutes as in effect July 15, 1996.

having one (1) or more individuals receiving compensation as defined in KRS 141.120(8)(b) in this state[.]" The Corporations argue that since the parties stipulated that the Corporations did not own property, lease property, or have individuals receiving compensation in Kentucky, they are not subject to Kentucky corporate income tax. The Cabinet argues that the circuit court correctly held that regardless of KRS 141.040(1), the Corporations are subject to taxation pursuant to KRS 141.206(5), which provides:

> Nonresident individuals and corporations which are partners in a partnership or shareholders in an S corporation which does business within and without Kentucky are taxable on their proportionate share of the distribute income passed through the partnership or S corporation attributable to business done in Kentucky.

Simply put, we agree with the Cabinet and the circuit court that the plain language of KRS 141.206(5) subjects the Corporations to taxation. A different result is not compelled, as the Corporations suggest, by the fact that KRS 141.206(5) does not contain the words "shall pay." We hold that the words "are taxable" are sufficient to impose tax liability in this situation. Further, a different result is not compelled by any subsequent amendments to these statutes.

Appendix A

Void for Vagueness

The Corporations assert that KRS 141.206 is void for vagueness. In *Bd. of Trs. of the Judicial Form Ret. Sys. v. Attorney Gen.*, 132 S.W.3d 770 (Ky. 2003), the Kentucky Supreme Court held that unintelligible legislation was a nullity. Specifically, the court stated:

> The void-for-vagueness doctrine is most often applied in the context of the First Amendment, the criminal law, and punitive civil laws. *See, e.g. Martin v. Commonwealth, Ky.*, 96 S.W.3d 38, 59-60 (2003) (First Amendment); *Jones v. Commonwealth, Ky.*, 830 S.W.2d 877, 880 (1992) (criminal law); *Vill. of Hoffman Estates v. Flipside*, 455 U.S. 489, 499-500, 102 S.Ct. 1186, 1193-94, 71 L.Ed.2d 362 (1982) (civil penalties). However, while statutes affecting those areas should receive the most *rigorous* review and are most *commonly* held void for vagueness, non-punitive civil, regulatory, or spending statutes are also invalid if they are so unintelligible as to be incapable of judicial interpretation. In that circumstance, the statute often is declared void for "unintelligibility" or "uncertainty" as opposed to "vagueness."
>
> The most oft-cited expression of this doctrine in Kentucky is *Folks v. Barren County*, 313 Ky. 515, 232 S.W.2d 1010 (1950), in which our predecessor court was asked to

> interpret a statute allowing boards of education to finance new school buildings through direct appeals to voters. The Court noted the following proposition of law:
>
> > It is not for us to say the Legislature does not have the right to be indirect where it could be direct, or to be obscure and confusing where it could be clear and simple. But where the law-making body, in framing the law, has not expressed its intent intelligibly, or *in language that the people upon whom it is designed to operate or whom it affects can understand, or from which the courts can deduce the legislative will,* the statute will be declared to be inoperative and void.

Id. at 778. We hold that this principle has no applicability to the instant statute.

The legislative will expressed in KRS 141.206(5) is intelligible. It expresses the policy that nonresident corporations, such as the Corporations herein, which are partners in a partnership doing business within and without Kentucky are taxable on their proportionate share of distributive income passed through the partnership attributable to business done in Kentucky. The Corporations' allegations of deficiencies—absence of tax rate, "imposition" language, lack of clarity—are without merit. The applicable tax rate is supplied by KRS 141.040. As noted above, the statute contains imposition language. And, the statute is sufficiently

clear. This conclusion is supported in part by the fact that Asworth filed a corporate income tax return in the first place. The statute is not void for vagueness, *i.e.*, unintelligibility.

Commerce Clause

Next, the Corporations argue that subjecting them to tax under KRS 141.206(5) violates the Commerce Clause. We disagree.

To withstand an attack on Commerce Clause grounds, a tax must be: (1) nondiscriminatory toward interstate commerce; (2) applied to one or more activities with a substantial nexus with the taxing state; (3) fairly apportioned; and (4) fairly related to services provided by the state. *Revenue Cabinet v. Ashland Oil, Inc.*, 888 S.W.2d 701, 704 (Ky.App. 1994) (quoting *Complete Auto Transit v. Brady*, 430 U.S. 274, 97 S.Ct. 1076, 51 L.Ed.2d 326 (1977)).

While the Corporations assert in their brief that taxing them under KRS 141.206(5) violates each of the *Complete Auto Transits* prongs, they seriously argue only with regard to the second prong. The Corporations cite *Quill Corp. v. North Dakota*, 504 U.S. 298, 112 S.Ct. 1904, 119 L.Ed.2d 91 (1992), in arguing that the "substantial nexus" requirement can only be satisfied through a physical presence with the taxing state, which is a status the Corporations do not have with Kentucky. In addressing the sales and use taxes at issue in *Quill*, the Supreme Court reaffirmed its previous bright-line

rule that "a vendor whose only contacts with the taxing State are by mail or common carrier lacks the 'substantial nexus' required by the Commerce Clause." 504 U.S. at 311, 112 S.Ct. at 1912. However, the Supreme Court recognized that it had not articulated the same physical-presence requirement in reviewing other types of taxes. 504 U.S. at 314, 112 S.Ct. at 1914. Thus, the applicability of *Quill*'s physical presence requirement to income tax cases, such as the matter before us, is unclear. Nevertheless, even if a substantial nexus requires a physical presence in Kentucky, for the reasons stated hereafter we hold that the Corporations in fact have such a nexus.

Again, while the Corporations do no business in Kentucky, at various times they have owned up to a 99% limited and/or general partnership interest in, and have received distributive shares of partnership income from the profits of, a partnership which does business in Kentucky. Such a partnership unquestionably has received protection and benefits from Kentucky, thereby enabling the distribution of income to the Corporations. We hold that this connection gives rise to a substantial nexus with, and/or a physical presence within, Kentucky. *Accord Borden Chemicals & Plastics, L.P. v. Zehnder*, 312 Ill. App. 3d 35, 726 N.E.2d 73, 79-82, 244 Ill. Dec. 477 (Ill.App. 2000) (commerce clause does not prohibit Illinois from assessing replacement tax on a limited partner which has no connection with the State of Illinois other than investing in a partnership). The cases from other jurisdictions cited by the Corporations and/or the tax expert's testimony below regarding the physical presence standard do not compel a different result.

Appendix A

Due Process Clause

Next, the Corporations argue that subjecting them to tax under KRS 141.206(5) violates the Due Process Clause of the Fourteenth Amendment. We disagree.

The *Quill* court explained that "[t]he Due Process Clause 'requires some definite link, some minimum connection, between a state and the person, property or transaction it seeks to tax[.]'" 504 U.S. at 306, 112 S.Ct. at 1909 (quoting *Miller Brothers Co. v. Maryland*, 347 U.S. 340, 344-45, 74 S.Ct. 535, 539, 98 L.Ed. 744 (1954)). The Court has "framed the relevant inquiry as whether a defendant had minimum contacts with the jurisdiction 'such that the maintenance of the suit does not offend "traditional notions of fair play and substantial justice."'" *Quill*, 504 U.S. at 307, 112 S.Ct. at 1910 (quoting *International Shoe Co. v. Washington*, 326 U.S. 310, 316, 66 S.Ct. 154, 158, 90 L.Ed. 95 (1945)). The Corporations argue that they have no "definite link" or "minimum connection" with Kentucky. However, as with our Commerce Clause analysis, we hold that the Corporations' ownership interest in, and receipt of income from, a partnership doing business in Kentucky provides the requisite link for taxation under the Due Process Clause. *Accord Borden Chemicals & Plastics, L.P.*, 726 N.E.2d at 78-79.

Apportionment

The Cabinet argues that since the circuit court concluded that the Corporations were subject to

taxation pursuant to KRS 141.206(5), it should have used the single-factor formula found therein to calculate the amount owed. Instead, the circuit court applied the three-factor formula found in KRS 141.120(8). We agree that KRS 141.206(5) contains the proper apportionment formula.

The circuit court held that the three-factor formula found in KRS 141.120(8) provided the correct method for calculating the taxes the Corporations owed, as that method "seems to be logical from a legal standpoint. To prevent the [Corporations] from applying this method, would possibly infringe on the [Corporations'] constitutional rights." Thus, the circuit court concluded not that the legislature intended for taxpayers to use the three-factor formula in situations such as these, but instead that prohibiting taxpayers from using the three-factor formula would subject the formula to possible constitutional problems. We disagree with the circuit court's reasoning.

"The cardinal rule of statutory construction is to ascertain and give effect to the intent of the legislature." *Ky. Ins. Guar. Ass'n v. Jeffers ex rel. Jeffers*, 13 S.W.3d 606, 610 (Ky. 2000). As set forth above, KRS 141.206(5) provides that nonresident corporations "are taxable on their proportionate share of the distributive income passed through the partnership . . . attributable to business done in Kentucky" if they are partners in a partnership "which does business within and without Kentucky[.]" Further, KRS 141.206(5)(a) provides: "Business done in Kentucky is determined by the ratio

of gross receipts from sales to purchasers or customers in Kentucky or services performed in Kentucky to the total gross receipts from sales or service everywhere." The plain language of these provisions compels a finding that the legislature intended for the amount of tax owed under this section to be calculated using the formula found therein. Accordingly, the circuit court erred by applying instead the formula found in KRS 141.120(8).

The question then becomes whether the application of this formula to the matter *sub judice* is constitutional. The Supreme Court explained in *Container Corp. of America v. Franchise Tax Bd.*, 463 U.S. 159, 164, 103 S.Ct. 2933, 2939-40, 77 L.Ed.2d 545 (1983):

> Under both the Due Process and the Commerce Clauses of the Constitution, a state may not, when imposing an income-based tax, "tax value earned outside its borders." In the case of a more-or-less integrated business enterprise operating in more than one State, however, arriving at precise territorial allocations of "value" is often an elusive goal, both in theory and in practice. For this reason and others, we have long held that the Constitution imposes no single formula on the States, and that the taxpayer has the "distinct burden of showing by 'clear and cogent evidence' that [the state tax] results in extraterritorial values being taxed . . . ."

(Internal citations omitted.) Here, the application of the formula found in KRS 141.206(5) will not result in

extraterritorial values being taxed, as the provision requires taxation of the "proportionate share of the distributive income passed through the partnership . . . attributable to business done in Kentucky." Again, "[b]usiness done in Kentucky is determined by the ratio of gross receipts from sales to purchasers or customers in Kentucky or services performed in Kentucky to the total gross receipts from sales or service everywhere." KRS 141.206(5)(a). This necessarily excludes extraterritorial values.

The Corporations argue that we should remand, directing the Board to admit into evidence and consider a tax expert's opinion regarding which formula to apply. However, we believe that the Board's error, if any, in failing to admit this evidence was harmless. First, the Board never reached the issue of which formula should apply since it held that the Corporations did not have the appropriate nexus with Kentucky. Second, the tax expert essentially opined that the three-factor formula is preferable from a policy perspective because it accounts for two key business inputs that the single-factor formula does not. Nevertheless, this court's role is not to decide policy. Rather, it is to "ascertain and give effect to the intent of the legislature." *Ky. Ins. Guar. Ass'n*, 13 S.W.3d at 610.

Payment Motion

Finally, the Cabinet argues that the circuit court erred by granting the Corporations' motion seeking immediate payment of their refunds. We agree.

Under KRS 131.365 and KRS 134.580, a refund payment is not due immediately. KRS 131.365(4) directs that payment shall be ordered on appeal. This section provides: "In the case of any appeal, any taxes, interest, or penalty paid but found by the board to be in excess of that legally due shall be ordered refunded to the taxpayer." The Cabinet argues that this statute is silent regarding the timing of any payment; however, we hold that the plain language directs that any payment shall be ordered upon appeal.

KRS 134.580(2) provides:

> When money has been paid into the State Treasury in payment of any state taxes, except ad valorem taxes, whether payment was made voluntarily or involuntarily, the appropriate agency shall authorize refunds to the person who paid the tax, or to his heirs, personal representatives or assigns, of any overpayment of tax and any payment where no tax was due. When a bona fide controversy exists between the agency and the taxpayer as to the liability of the taxpayer for the payment of tax claimed to be due by the agency, the taxpayer may pay the amount claimed by the agency to be due, and if an appeal is taken by the taxpayer from the ruling of the agency within the time provided by KRS 131.340 and it is finally adjudged that the taxpayer was not liable for the payment of the tax or any part thereof, the agency shall

> authorize the refund or credit as the Kentucky Board of Tax Appeals or courts may direct.

A refund payment under this statute is not due until the matter is "finally adjudged" by either the Board or a court. Thus, pursuant to these two statutes, the Corporations are not entitled to immediate payment of any refund.

The Bills

The Corporations assert that the Bills are invalid because they unconstitutionally and retroactively deprive the Corporations of interest on their tax refunds and/or claims. We disagree.

The Bills amended KRS 131.183, 141.044, 141.235 and 134.580 to provide, in part, that for tax refunds issued after a certain date, interest may begin to accrue as late as the date of filing an amended return, and at a rate of "prime minus 2%." The Bills also provide that these changes apply "retroactively on all outstanding refund claims for taxable years ending before December 31, 1995, and shall apply to all claims for such taxable years pending in any judicial or administrative forum." For numerous reasons, discussed below, the Corporations challenge the Bills' validity, including, but not limited to their contention that the Bills deprive them of interest on their overpayment for the interim period between the payment of the tax, or the due date of the return, and the date of filing the amended return, and that the retroactive effect of the Bills is unconstitutional.

First, the Corporations argue that the Bills are unconstitutional under due process provisions of federal and state law. In particular, the Corporations argue that they are constitutionally entitled to refunds on any overpayments of tax, and that interest constitutes part of the overpayment which must also be refunded. They claim not only that the Bills improperly deprive them of interest on their overpayments for up to four years, but also that the retroactively payable interest rate was improperly reduced to prime rate minus 2%.

Regardless of whether interest is considered part of an overpayment of tax, "[t]ax legislation is not a promise, and a taxpayer has no vested right in the Internal Revenue Code." *United States v. Carlton*, 512 U.S. 26, 33, 114 S.Ct. 2018, 2023, 129 L.Ed.2d 22 (1994). Neither is there a vested right in Title XI[5] of KRS, relating to Revenue and Taxation. Justice Stone explained in *Welch v. Henry*, 305 U.S. 134, 146-47, 59 S.Ct. 121, 125, 83 L.Ed. 87 (1938):

> Taxation is neither a penalty imposed on the taxpayer nor a liability which he assumes by contract. It is but a way of apportioning the cost of government among those who in some measure are privileged to enjoy its benefits and must bear its burdens. Since no citizen enjoys immunity from that burden, its retroactive imposition does not necessarily infringe due process[.]

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5. KRS Chapters 131 to 144.

Appendix A

The Supreme Court "repeatedly has upheld retroactive tax legislation against a due process challenge." 512 U.S. at 30, 114 S.Ct. at 2021. As long as retroactive application of the Bills to the statutes is "rationally related to a legitimate legislative purpose," due process is not violated. *Id.* at 35, 114 S.Ct. at 2024. Retroactive application of tax legislation has been held to be rationally related to the legitimate governmental purpose of raising revenue, in order to prevent a "significant and unanticipated revenue loss." *Id.* at 32, 114 S.Ct. at 2023.

The issue then is whether retroactive application of the Bills rationally furthers the legitimate governmental purpose of raising revenue, to prevent a significant and unanticipated revenue loss. The Corporations argue that the fiscal notes to both Bills indicate that the Bills are to have no fiscal impact on the Commonwealth and thus, raising revenue could not have been the purpose of the Bills. However, while the Bills may not expressly state their expected fiscal impact, such an omission is not dispositive to the determination of whether the Bills rationally further the purpose of raising revenue.

"Revenue raising is certainly a legitimate legislative purpose, and any law that retroactively adds a tax, removes a deduction, or increases a rate rationally furthers that goal." *Id.* at 40, 114 S.Ct. at 2027. (Scalia, J., concurring) (internal citations omitted). The Bills at issue herein have the effect of potentially shortening the time period for which a taxpayer may accrue interest on an overpayment of tax, and decreasing the rate at which said interest accrues---effects clearly intended to

increase revenue for the Commonwealth. Since the Bills rationally further the legitimate governmental purpose of raising revenue, we hold that they satisfy the "rational basis" test articulated in *Carlton*.

The Corporations also contend that the four-year period of retroactivity in this case fails to meet the "modesty requirement" of retroactive tax legislation under *Carlton*. However, contrary to the Corporations' assertion, the holding in *Carlton* did not establish such a "modesty requirement;" rather, the majority simply noted with favor that "Congress acted promptly and established only a modest period of retroactivity." *Id.* at 32, 114 S.Ct. at 2023. This suggests to us that the period of retroactivity is to be considered in determining whether the legislation rationally furthers a legitimate governmental purpose. Here, the Bills retroactively applied to all outstanding refund claims for taxable years ending prior to the Bills'effective dates, and to all claims for those taxable years pending in any judicial or administrative forum. We hold that the retroactive period extending to outstanding claims as of the Bills' effective dates does not violate the due process clause.

Second, the Corporations claim that the Bills violate equal protection provisions of federal and state law because their effective dates treat similarly situated taxpayers differently.[6] In other words, the Corporations

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6. The Fourteenth Amendment to the United States Constitution requires persons who are similarly situated to be treated alike. *Durham v. Peabody Coal Co.*, 272 S.W.3d 192, 195 (Ky. 2008) (citing *City of Cleburne, Tex. v. Cleburne Living Ctr.*, 473 U.S. 432, 439, 105 S.Ct. 3249, 3254, 87 L.Ed.2d 313, 320 (1985)).

assert that taxpayers who receive refunds after the effective dates will receive interest for a shorter period of time, and calculated at a lower rate, than taxpayers who received refunds prior to these dates.

Germane to the Corporations' claim is the well-established power of the government to tax and to enact legislation which controls the revenue system. "The broad discretion as to classification which a legislature possesses in the field of taxation has long been recognized." *Commonwealth, Revenue Cabinet v. Smith*, 875 S.W.2d 873, 875 (Ky. 1994). "Further, in a taxation case, unless a rational basis for such law can be completely refuted, then the law may stand as constitutional." *Id.*

"Statutes are presumed to be valid and those concerning social or economic matters generally comply with federal equal protection requirements if the classifications that they create are rationally related to a legitimate state interest." *Durham v. Peabody Coal Co.*, 272 S.W.3d 192, 195 (Ky. 2008) (citing *City of Cleburne, Tex. v. Cleburne Living Ctr.*, 473 U.S. 432, 440, 105 S.Ct. 3249, 3254, 87 L.Ed.2d 313, 320 (1985)). "A statute complies with Kentucky equal protection requirements if a 'reasonable basis' or 'substantial and justifiable reason' supports the classifications that it creates." *Durham*, 272 S.W.3d at 195 (quoting *Elk Horn Coal Corp. v. Cheyenne Res., Inc.*, 163 S.W.3d 408 (Ky. 2005)); *Waggoner v. Waggoner*, 846 S.W.2d 704 (Ky. 1992). This "rational basis" test is the same for due process, as discussed above, and again, the Bills satisfy its

requirements. Consequently, the Corporations' equal protection claim is without merit.

Third, the Corporations argue that application of the Bills constitutes an unconstitutional "taking" of the Corporations' interest in their refund claims and tax overpayments under the Fifth Amendment to the United States Constitution, the takings clause, and Ky. Const. § 13.[7]

> [I]t is . . . well settled that [the due process] clause [of the 5th Amendment] is not a limitation upon the taxing power conferred upon Congress by the Constitution; in other words, that the Constitution does not conflict with itself by conferring, upon the one hand, a taxing power, and taking the same power away, on the other, by the limitations of the due process clause. And no change in the situation here would arise even if it be conceded, as we think it must be, that this doctrine would have no application in a case where, although there was a seeming exercise of the taxing power, the act complained of was so arbitrary as to constrain to the conclusion that it was not the exertion of taxation, but a

7. The Fifth Amendment provides: "nor shall private property be taken for public use, without just compensation." Ky. Const. § 13 provides: "nor shall any man's property be taken or applied to public use without the consent of his representatives, and without just compensation being previously made to him."

> confiscation of property; that is, a taking of the same in violation of the 5th Amendment; or, what is equivalent thereto, was so wanting in basis for classification as to produce such a gross and patent inequality as to inevitably lead to the same conclusion.

Brushaber v. Union Pac. R.R., 240 U.S. 1, 24-25, 36 S. Ct. 236, 244, 60 L. Ed. 493, T.D. 2290 (1916) (holding, in part, that the retroactive effect of certain income tax provisions, fixing an earlier date as the time from which the income was to be computed, did not violate the due process clause of Fifth Amendment.); *see A. Magnano Co. v. Hamilton*, 292 U.S. 40, 44, 54 S.Ct. 599, 601, 78 L.Ed. 1109 (1934) (The due process clause "is applicable to a taxing statute . . . only if the act be so arbitrary as to compel the conclusion that it does not involve an exertion of the taxing power, but constitutes, in substance and effect, the direct exertion of a different and forbidden power, as, for example, the confiscation of property."). Here, the adjustment of the interest rate on tax refunds is not such an exertion of the legislative taxing power so as to constitute a "taking" of property for public use. Thus, the Corporations argument in this respect fails.

Fourth, the Corporations assert that the Bills violate Ky. Const. § 51, which provides, in pertinent part: "No law enacted by the General Assembly shall relate to more than one subject, and that shall be expressed in the title[.]" Specifically, the Corporations contend that the Bills' title "An act relating to fiscal matters and declaring

an emergency" contains more than one subject and insufficiently expresses the subject matter contained therein.

In *Commonwealth ex rel. Armstrong v. Collins*, 709 S.W.2d 437, 443 (Ky. 1986), the Kentucky Supreme Court confirmed that the portion of § 51 cited above permits a legislative act to pertain to only a single subject, which must be described in the act's title. Nevertheless, this section of the Constitution "has always been liberally construed, with all doubts being resolved in favor of the validity of the legislative action." *Id.* "The purpose of the section is said to be to prevent the enactment of 'surreptitious' legislation." *Id.* (citing *Bowman v. Hamlett*, 159 Ky. 184, 188, 166 S.W. 1008, 1009 (1914); *Dawson v. Commonwealth, Dep't of Transp.*, 622 S.W.2d 212 (Ky. 1981)).

In *E. Ky. Coal Lands Corp. v. Commonwealth*, 127 Ky. 667, 702-03, 106 S.W. 260, 271, 108 S.W. 1138, 32 Ky. L. Rptr. 129, 33 Ky. L. Rptr. 49 (1907), the court held that the title "A act relating to revenue and taxation" did not violate § 51, reasoning that "'[n]one of the provisions of a statute should be regarded as unconstitutional, where they all relate directly or indirectly to the same subject, have an natural connection, and not foreign to the subject expressed in its title.'" *Id.* (quoting *Phillips v. Cin. & Cov. Bridge Co.*, 59 Ky. (2 Met.) 219 (1859)). "In *L. & O. Turnpike Co. v. Ballard*, 59 Ky. (2 Met.) 165 (1859), it was said: 'A more liberal construction of this clause of the Constitution will be not only more consistent with the objects intended

to be accomplished by it, but will be found necessary in the practical business of legislation.'" *E. Ky. Coal*, 127 Ky. at 703-04, 106 S.W. at 271.

Here, the Corporations do not contend that the Bills contain surreptitious legislation; rather, they take issue with the title itself. However, under a liberal construction historically afforded to § 51, we hold that the portions of the Bills at issue herein, relating to tax refunds, properly fall within the category of "fiscal matters" and thus, the title of the Bills sufficiently express the subject matter contained therein.

Lastly, the Corporations aver that the Bills are impermissible special legislation in violation of Ky. Const. § 59, which prohibits the General Assembly from passing local or special acts concerning various subjects, including "To regulate the rate of interest." The Corporations argue that the Bills arbitrarily treat taxpayers who received refunds prior to the effective dates differently from those who will receive refunds after those dates, and disproportionately classify interest rates for refunds and assessments, for no distinct or natural reason.

"Classification is a necessary feature and power of legislation, as it is impossible for any extensive code of laws to apply to every person or subject in the state." *City of Louisville v. Commonwealth*, 134 Ky. 488, 496, 121 S.W. 411, 413 (1909). In *Ravitz v. Steurele*, 257 Ky. 108, 120, 77 S.W.2d 360, 366 (1934), the court held constitutional an act which "provides an extensive,

efficient system for the control, regulation, and the general supervision of the class of money lenders embraced by it." In so ruling, the court reasoned that the act's "intendment and purpose is to control, regulate, and supervise the business of the money lenders classified by it, and, in so far as it deals with the subject of interest, it does so incidentally and as a part of the system of regulation and control therein provided." *Id.* Thus, "[a]s its provisions relate to interest, it is not a local or special law[.]" *Id.*

By the same token, insofar as the Bills at issue herein deal with the subject of interest, they do so incidentally and as part of a system of controlling, regulating, and supervising tax refunds. The effective dates, after which taxpayers are susceptible to different interest rates, are neither arbitrary nor unreasonable, and do not undertake in any way to fix or regulate the rate of interest. Thus, the challenged portions of the Bills herein are not impermissible special legislation in violation of Ky. Const. § 59 with respect to regulating the rate of interest.

The Franklin Circuit Court's order is affirmed in part, reversed in part, and remanded for further proceedings.

ALL CONCUR.

APPENDIX B — ORDER NO. K-19449 AND FINDINGS OF FACT, CONCLUSIONS OF LAW AND FINAL ORDER, COMMONWEALTH OF THE KENTUCKY BOARD OF TAX APPEALS DATED JANUARY 27, 2006

COMMONWEALTH OF KENTUCKY
KENTUCKY BOARD OF TAX APPEALS
FILE NUMBERS K00-R-31, K02-R-30,
K02-R-31 AND K02-R-32

ASWORTH CORPORATION, HT-FORUM, INC. (N/K/A HTF, LLC) AND D AVIATION SERVICES, INC. (N/K/A D AVIATION SERVICES, LLC)

APPELLANT

v.

REVENUE CABINET (N/K/A FINANCE AND ADMINISTRATION CABINET, DEPARTMENT OF REVENUE), COMMONWEALTH OF KENTUCKY

APPELLEE

ORDER NO. K-19449

After consideration of all evidence presented at the hearing on October 12, 2005 and having reviewed the case including briefs, proposed finding of fact and conclusions of law and being otherwise sufficiently advised, the Kentucky Board of Tax Appeals hereby enters the following findings of fact, conclusions of law and order:

Appendix B

FINDINGS OF FACT, CONCLUSIONS OF LAW AND FINAL ORDER

This matter was brought before the Kentucky Board of Tax Appeals by petition of ASWORTH CORPORATION. Consolidated with that petition were similar appeals by HT-FORUM, INC. (N/K/A HTF, LLC) and D AVIATION SERVICES, INC. (N/K/A D AVIATION SERVICES LLC). It was stipulated that all issues arising in the ASWORTH appeal are common to all other APPELLANTS. As such all similarly situated parties will be referred to herein jointly as APPELLANT.

APPELLANT'S petition raised several issues regarding the final ruling of the REVENUE CABINET (N/K/A FINANCE AND ADMINISTRATION CABINET, DEPARTMENT OF REVENUE) COMMONWEALTH OF KENTUCKY, referred to herein as THE DEPARTMENT. By agreement and/or stipulation many of the issues raised in the petition were resolved between the parties during the morning session of the hearing in this matter held in Frankfort before the full board on October 12, 2005.

With the generous assistance of counsel for both parties nearly all facts necessary for a determination of the issues in this case were agreed to or stipulated.

Of particular significance THE DEPARTMENT, through counsel, stipulated that the APPELLANT was, at all relevant times a foreign corporation. THE

DEPARTMENT also stipulated that APPELLANTS sole connection with the Commonwealth was its receipt of a distributive share of partnership income received from the profits of variously named and organized partnerships doing business in Kentucky.

THE DEPARTMENT also stipulated that during the tax periods at issue in this case a "substantial nexus" with Kentucky was required in order for the Commonwealth to collect an income tax on foreign corporations.

While THE DEPARTMENT stipulated that THE APPELLANT had no "physical presence" in the Commonwealth THE DEPARTMENT took the position that "physical presence" was not required in order for Kentucky to impose income tax on THE APPELLANT. THE DEPARTMENT argued that THE APPELLANT'S receipt of a "partnership distributive share" from an entity doing business in Kentucky was enough to satisfy the "substantial nexus" test.

APPELLANT argues that the imposition of income tax on foreign corporations during the periods in question was limited to those foreign corporations "owning or leasing property located in this state or having one (1) or more employees receiving compensation . . . in this state". KRS 141.040. Because THE DEPARTMENT agreed that APPELLANT did not meet this test APPELLANT argues that it was not subject to income taxes.

APPELLANT also advanced the argument that before Kentucky can constitutionally impose an income tax on foreign corporations a "physical presence" is necessary in order to satisfy the constitutionally required "substantial nexus" test.

The parties also argued that should the Board decide that THE APPELLANT was subject to corporate income tax that either a "single prong" test (THE DEPARTMENT'S position) or a "three prong" test (THE APPELLANT'S position) for apportionment should be applied in calculating that tax. Because we find that a much narrower issue is dispositive of this case, we do not reach this or the other issues presented for consideration.

FINDINGS OF FACT

Based upon the stipulations and agreements of the parties in the record of this matter the Board makes the following FINDINGS OF FACT.

1. THE APPELLANT is a foreign corporation.

2. THE APPELLANT had no "physical presence" in Kentucky during the relevant tax periods.

3. THE APPELLANT received a distributive share of income from partnership entities doing business in Kentucky during the relevant tax periods and this was THE APPELLANT'S sole connection with Kentucky.

4. THE APPELLANT neither owned nor leased property in Kentucky nor had one or more employees receiving compensation in Kentucky during the relevant tax periods.

CONCLUSIONS OF LAW

Based upon the entire record and the FINDINGS OF FACT made above, the Board makes the following CONCLUSIONS OF LAW.

During the relevant tax periods the Kentucky Legislature imposed a tax upon foreign corporations owning or leasing property in this state or which had one or more employees receiving compensation in this state. KRS 141.040. During these periods Kentucky did not impose a tax on partnerships.

Because THE APPELLANTS did not own or lease property in Kentucky or have one or more employees receiving compensation here the clear and unambiguous language of KRS 141.040 did not reach the distributive share paid to them by partnerships doing business in the Commonwealth.

Because we believe that it is our function to consider the narrowest issue which is dispositive of this controversy we need not address the other issues raised by these appeals.

Appendix B

ORDER

IT IS HEREBY ORDERED that the APPELLANTS are relieved of the taxes, penalties and interest which are the subject of this appeal and entitled to all other relief afforded by statute for the collection and enforcement of this order.

This is a final and appealable order. All final orders of this agency shall be subject to judicial review in accordance with the provisions of KRS Chapter 13B. A party shall institute an appeal by filing a petition in the Circuit Court of venue, as provided in the agency's enabling statutes, within thirty (30) days after the final order of the agency is mailed or delivered by personal service. If venue for appeal is not stated in the enabling statutes, a party may appeal to Franklin Circuit Court or the Circuit Court of the county in which the appealing party resides or operates a place of business. Copies of the petition shall be served by the petitioner upon the agency and all parties of record. The petition shall include the names and addresses of all parties to the proceeding and the agency involved, and a statement of the grounds on which the review is requested. The petition shall be accompanied by a copy of the final order.

A party may file a petition for judicial review only after the party has exhausted all administrative remedies available within the agency whose action is being challenged, and within any other agency authorized to exercise administrative review.

Appendix B

A petition for judicial review shall not automatically stay a final order pending the outcome of the review, unless:

(a) An automatic stay is provided by statute upon appeal or at any point in the administrative proceedings;

(b) A stay is permitted by the agency and granted upon request; or

(c) A stay is ordered by the Circuit Court of jurisdiction upon petition.

Within twenty (20) days after service of the petition of appeal, or within further time allowed by the Circuit Court, the Kentucky Board of Tax Appeals shall transmit to the reviewing court the original or a certified copy of the official record of the proceeding under review in compliance with KRS 13B.140(3).

DATE OF ORDER
AND MAILING: January 27, 2006

KENTUCKY BOARD OF TAX APPEALS
FULL BOARD CONCURRING

s/Nancy Mitchell

NANCY MITCHELL
CHAIR

APPENDIX C — ORDER OF THE COMMONWEALTH OF KENTUCKY FRANKLIN CIRCUIT COURT DIVISION II DATED DECEMBER 4, 2007

COMMONWEALTH OF KENTUCKY
FRANKLIN CIRCUIT COURT
DIVISION II
CIVIL ACTION NO. 06-CI-00288

REVENUE CABINET (N/K/A FINANCE AND ADMINISTRATION CABINET, DEPARTMENT OF REVENUE), COMMONWEALTH OF KENTUCKY

APPELLANT

v.

ASWORTH CORPORATION (N/K/A ASWORTH, LLC), HT-FORUM, INC (N/K/A HTF, LLC) AND D AVIATION SERVICES, INC. (N/K/A D AVIATION SERVICES, LLC)

APPELLEES

ORDER

This action is back before the Court on the Motion of the Appellees to alter, amend or vacate (the "Motion") the Court's Order of June 14, 2007 (the "Order"). This motion must be granted, at least in part, for the following reasons:

Appendix C

The Court, in its Order, originally ordered the case to be remanded to the Kentucky Board of Tax Appeals (the "Board") for a determination of the amount of the refund due in light of the holdings in the Order, specifically that the Appellees did not prevail on their nexus argument, but did prevail on their apportionment argument. The parties have in fact stipulated to that amount, and therefore, there is no need to remand this case to the Board for a finding on this issue. As a result this conclusion was incorrect.

In addition, because there is no need to remand the case, it is appropriate to address other legal issues that were not addressed in the Order, specifically, the Commerce Clause and Due Process arguments, as well as Appellees' Motion to Direct Appellant to Refund Taxes, Penalties, Costs, Fees and Interest (the "Payment Motion"), and to add finality language.

As a result, the Court hereby grants the Motion, to the extent that (i) remand to the Board is not needed to determine the amount of refund due if Appellees have nexus with Kentucky but are entitled to apportionment, (ii) the Commerce Clause and Due Process Clause issues and the Payment Motion should be addressed in an order and (iii) finality language should be added. The remaining relief sought in Appellees' Motion is hereby denied.

In accordance with this ruling the Order is hereby amended and restated in its entirety to read as follows:

Appendix C

This matter is before the Court upon an appeal from the Kentucky Board of Tax Appeals (the "Board"). The Appellant Revenue Cabinet (Finance & Administration Cabinet, Department of Revenue, Commonwealth of Kentucky) ("Revenue") appeals Board Order No. K-19449 which held that the Appellees (primarily "Asworth") were not subject to Kentucky corporation income tax. The Board based its Order on the fact that the Appellees did not own or lease property in Kentucky, nor have any employees in Kentucky, pursuant to the requirements of KRS 141.040. The Court has reviewed the record, arguments of counsel and all applicable law and now **REVERSES** the Order of the Board.

The facts reveal that this case involves tax years dating back to 1993. The actual years in contention involve taxable periods ending January 31, 1993 through January 31, 1996. Asworth initially owned a 99% limited partnership interest in Conwood Company, LP ("Conwood"), a Delaware limited partnership which conducted business both within and outside Kentucky.[1]

For the taxable periods ending January 31, 1993 through January 31, 1996, Appellees filed Kentucky corporation income tax returns and paid Kentucky corporation income tax calculated by including property,

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[1] Asworth's corporate structure changed between November 1, 1996 through April 30, 1997 as (1) Asworth contributed 1% of its limited partnership interest in D Aviation Services, Inc., n/k/a D Aviation Services LLC ("D Aviation"), (2) GP Corporation merged with Asworth, who acquired GP Corporation's 1% general partnership interest in Conwood, and (3) Asworth converted 51% of its limited partnership interest in Conwood into a general partnership interest.

(Cont'd)

payroll and receipts of both Asworth and Conwood. Appellee utilized the three-factor, sales double-weighted apportionment method in calculating this tax payment.

Revenue conducted a corporation income tax audit of Asworth for taxable years ending January 31, 1993 thru January 31, 1996. At the end of the audit, Revenue assessed Asworth an additional $654,629 income tax liability, plus applicable interest and penalties. This

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(Cont'd)

Asworth thereafter contributed its 47% limited partnership interest in Conwood to HT-Forum, Inc., n/k/a HTF, LLC ("HTF", Asworth, HTF and D Aviation are collectively referred to as "Appellees" or "Taxpayers") and Conwood Sales Company ("Conwood Sales"), a Delaware limited partnership that does business within and without Kentucky, was formed. In return for this contribution, each partner of Conwood received an identical ownership interest in Conwood Sales.

On November 15, 1996, Asworth contributed 1% of its limited partnership interest in Conwood to D Aviation. Asworth contributed its limited partnership interests in Conwood and Conwood Sales to D Aviation on April 30, 1997, and D Aviation changed its tax year end to December 31, effective with the tax year ending December 31, 1997. Additional structural changes occured from May 1, 1997 through December 31, 1999.

The Taxpayers subsequently filed additional refund claims based on their assertion that they had no nexus with Kentucky, as their only connection with Kentucky was through their partnership interests in Conwood and Conwood Sales. These refund claims were also denied by Revenue. Revenue ultimately issued three more final rulings that Asworth appealed to the Board, which then consolidated the four final rulings into a single action. A hearing was held on October 12, 2005.

additional assessment was based on Revenue's assertion that the correct apportionment method, pursuant to KRS 141.206(5), is a single-factor receipt method — on Conwood receipts in Kentucky over Conwood receipts everywhere. Asworth elected to not protest this assessment and as a result, paid the $654,629, plus applicable penalties and interest. Asworth then filed a refund claim for both this amount and the prior amount paid when the returns were originally filed. The additional amount of the refund claim was based on Asworth's argument that it had no nexus with Kentucky, as its only connection with Kentucky was through its partnership interest in Conwood. In the alternative, Asworth asserted that its original filing method was correct, and that the single-factor receipts method should not be used. Revenue denied the refund claims and asserted that Asworth was subject to Kentucky corporation income tax on its distributive share of income from Conwood pursuant to KRS 141.206. Revenue ultimately issued a final ruling which Asworth then appealed to the Board. The Board agreed with Asworth, holding that the taxpayers were not subject to Kentucky corporation income tax pursuant to KRS 141.040. This appeal ensued.

In reviewing an agency decision, this Court may only overturn that decision if the agency acted arbitrarily or outside the scope if its authority, if the agency applied an incorrect rule of law, or if the decision itself is not supported by substantial evidence. *Kentucky State Racing Comm'n v. Fuller*, 481 S.W.2d 298, 300-301 (Ky. 1972). If the Court finds the correct rule of law

was applied to facts supported by substantial evidence, the final order of the agency must be affirmed. *Brown Hotel Company v. Edwards*, 356 S.W.2d 299, 302 (Ky. 1963). When the outcome of a case turns on an issue of law, as in the instant matter, appellate review is *de novo*. *Western Kentucky Coca-Cola Bottling Co., Inc. v. Revenue Cabinet*, 80 S.W.2d 787, 790 (2001). There is no requirement that the Court grant any deference to (administrative agency) where factual findings are not at issue. *Id.*

The Court's standard of review of the Board decision, an administrative determination, is primarily that of determining the property of "questions of law." *See Epsilon Trading Co. v. Revenue Cabinet*, 775 S.W.2d 937, 946 (Ky. App. 1989); *Revenue Cabinet v. Moors Resort, Inc.*, 675 S.W.2d 859 (Ky. App. 1984); *see also Williams v. Cumberland Valley Nat'l Bank*, 569 S.W.2d 711 (Ky. App. 1978) (holding that in general the judicial review of an administrative agency's actions should ensure that the agency has not acted arbitrarily).

The parties each agree that the matter before the Court involves a question of law and no factual issues are in dispute. The Order of January 27, 2006 of the Board of Tax Appeals found that there was no nexus by Appellees to the Commonwealth of Kentucky. To arrive at this conclusion, the Board of Tax Appeals would have to apply KRS 141.040 without acknowledging the existence of KRS 141.206. The Court agrees with the Appellant, Revenue Cabinet, that KRS 141.206 is an imposition statute. The Court also agrees that Asworth

has sufficient nexus, or contacts, with the State of Kentucky for taxing purposes.

Appellees are subject to tax on their distributive share income from partnerships doing business both within and without Kentucky pursuant to KRS 141.206. The Board erred in failing to address this issue in its Order. KRS 141.206 imposes income tax on individuals and corporations that carry on a business as partners in a partnership doing business in Kentucky. If a corporation has no property and payroll in Kentucky, but is a partner doing business in Kentucky, KRS 141.206 is the governing statute. The partnership pays no income tax; instead its partners are taxed on their distributive share of income attributable to the partnership doing business in Kentucky. KRS 141.206. Specifically, KRS 141.206(3) provides:

> Individuals or corporations carrying on business as a partnership or S corporation shall be liable for income tax only in their individual or corporate capacities, and no income tax shall be assessed upon the income of any partnership or S corporation except as prescribed in KRS 141.040(5).

KRS 141.206(3)(b) provides:

> Corporations which are partners must include their distributive share of net income, gain, loss, deduction or credit, as determined under subsection (2) of this section, except as provided in subsections (4) and (5) of this section.

Appendix C

KRS 141.206(5) provides:

> Nonresident individuals and corporations which are partners in a partnership or shareholders in an S corporation which does business within and without Kentucky are taxable on their proportionate share of the distributive income passed through the partnership or S corporation attributable to business done in Kentucky.
>
> (a) Business done in Kentucky is determined by the ratio of gross receipts from sales to purchases in Kentucky or sales performed in Kentucky to the total gross receipts form sales or service everywhere.

To summarize, KRS 141.206 recognizes the flow-thru nature of partnerships, and accordingly states that the income tax is not owed by the partnership, but rather imposes the income tax upon the partners. Moreover, the term "nonresident: has been consistently interpreted by Revenue, for purposes of KRS 141.206, to mean a corporation who is neither a Kentucky corporation nor a non-Kentucky corporation with property and payroll in Kentucky. Corporation Income tax is owed by Asworth.

CONSTITUTIONAL ISSUES

With respect to Asworth's Commerce Clause argument, the Commerce Clause requires that a tax

must be "applied to an activity with a substantial activity within the taxing state." *Complete Auto Transit, Inc. v. Brady*, 430 U.S. 274, 279 (1977). There is currently no bright line physical presence standard with respect to income tax for the substantial nexus test of the Commerce Clause. *Quill Corp. v. North Dakota*, 504 U.S. 298, 317 (1992). The substantial nexus test of the Commerce Clause may be satisfied even if the taxpayer does not have a physical presence within the taxing state. *Geoffrey, Inc. v. South Carolina Tax Comm'n*, 437 S.E.2d 13 (S.C. 1993); *Borden Chemicals and Plastics, L.P. v. Ken Zehnder*, 726 N.E.2d 73 (Ill. App. 1st 2000). Asworth's derivation of income from their partnership interests in partnerships doing business both within and without Kentucky satisfies the substantial nexus test of the Commerce Clause, and as a result, Asworth is subject to Kentucky corporation income tax on their distributive share income.

Similarly, the Due Process Clause "requires some definite link, some minimum connection, between a state and the person, property or transaction it seeks to tax." *Miller Bros. v. Maryland*, 347 U.S. 340, 344-45, 774 S. Ct. 535, 539 (1954). Here, the definite link or minimum connection is the Appellees' interest in partnerships that are doing business both within and without Kentucky, which has resulted in a substantial amount of distributive share income to Appellees from their partnerships' Kentucky activities. In addition, Appellees have purposefully directed their activities at Kentucky through their interest in Conwood and Conwood Sales. As a result, Appellees are constitutionally subject to

Kentucky corporation income tax on their distributive share income.

PROPER APPORTIONMENT METHOD

Having found taxes are applicable to Asworth, the next issue is whether the income subject to tax should be apportioned based upon the ratio of sales, property, and payroll in Kentucky to total sales, property, and payroll everywhere in the United States in order to accurately reflect income attributable to Kentucky. This Court rules that the three-factor method is the correct method of calculating taxes due to Appellant (See Exhibit C, Brief of Appellees). The three-factor apportionment seems to be logical from a legal standpoint. To prevent the Appellee from applying this method, would possibly infringe on the Appellees constitutional rights. The Court has found a minimum nexus and the Appellees should receive the benefit of the three-factor method. The Courts have long held that states are limited under the U.S. Constitution, to taxing only those amounts of income that bear a reasonable relationship to activities conducted in that sates. The Appellees are multi-state entities and should be fairly treated as such. *See Complete Auto Transit Inc. v. Brady*, 430 U.S. 274, 97 S. Ct 1076 (1977). KRS 141.120(8) [illegible] apportionment statute and KRS 141.[illegible] applicable for applying tax rates as Appellees are also multi-state corporations based in Delaware.

Appendix C

THE AMOUNT OF THE REFUND

The amount of the refund, based upon the Appellees prevailing upon the apportionment method, was stipulated to by the parties. The amount of the refund, based upon the apportionment method, with statutory interest accrued through August 31, 2007, is as follows: Asworth ($1,815,003.85 in tax and interest), HTF ($667,738.98 in tax and interest), and D Aviation ($5,975.73 tax and interest).

THE PAYMENT MOTION

In addition to the arguments raised on appeal, Asworth filed the Payment Motion, seeking payment of the refund immediately, rather than when this case is final and no longer on appeal. Asworth has indicated it is willing to post a bond equal to the amount of the payment sought.

The Court believes that such procedure as advanced by Asworth is correct and contemplated by KRS 131.370 (2) and KRS 131.365 (4).

Accordingly, the refunds memorialized in this Order, plus statutory interest pursuant to KRS 131.183

Appellees within fifteen (15) days of entry of this Order. The Ordered bond shall be in place no later than fifteen (15) days after such date of payment if either party seeks appellate review.

Appendix C

WHEREFORE, the Order of the Board of Tax Appeals is **REVERSED**, and the Motion to Alter, Amend, or Vacate is **GRANTED** in part and **DENIED** in part.

There being no just cause for delay, this is a final and appealable order.

SO ORDERED this 4th day of December, 2007.

/s/
Thomas D. Wingate, Judge
Franklin Circuit Court
Division II

DISTRIBUTION

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Laura M. Ferguson
Office of Legal Services in Support of Revenue
P.O. Box 423
Frankfort, KY 40602-0423

APPENDIX D— ORDER DENYING DISCRETIONARY REVIEW OF THE SUPREME COURT OF KENTUCKY FRANKLIN CIRCUIT COURT DATED AUGUST 18, 2010

SUPREME COURT OF KENTUCKY
FRANKLIN CIRCUIT COURT
2009-SC-0816-D
(2007-CA-2549 & 2008-CA-0023)

ASWORTH CORPORATION,
N/K/A ASWORTH, LLC, ET AL.

MOVANTS

V.

REVENUE CABINET, COMMONWEALTH OF KENTUCKY, N/K/A FINANCE & ADMINISTRATION CABINET, DEPARTMENT OF REVENUE

RESPONDENT

ORDER DENYING DISCRETIONARY REVIEW

The motion for review of the decision of the Court of Appeals is denied.

The opinion of the Court of Appeals is ordered not to be published.

ENTERED: August 18, 2010.

/s/
CHIEF JUSTICE

APPENDIX E — RELEVANT STATUTES
KENTUCKY REVISED STATUTES

TITLE XI. REVENUE AND TAXATION
CHAPTER 131. REVENUE CABINET
GENERAL PROVISIONS

KRS § 131.183 (Michie 1993)

§ 131.183. Tax interest rate

(1) All taxes payable to the Commonwealth not paid at the time prescribed by statute shall accrue interest at the tax interest rate. The tax interest rate for tax liabilities that are assessed on or after July 1, 1982, shall be sixteen percent (16%). This tax interest rate shall apply until January 1, 1983, when the tax interest rate shall be adjusted as provided in this section. The secretary of revenue shall adjust the tax interest rate not later than November 15 of any year, beginning in 1982, if the adjusted prime rate charged by banks during October of that year, rounded to the nearest full percent, is at least one (1) percentage point more or less than the tax interest rate which is then in effect. The tax interest rate shall be equal to the adjusted prime rate charged by banks rounded to the nearest full percent, and shall become effective on January 1 of the immediately succeeding year.

(2) Interest shall be allowed and paid upon any overpayment in respect of any of the taxes provided for in Chapters 131, 132, 134, 136, 137, 138, 139, 140, 141, 142, 143, 143A, and 243 of the Kentucky Revised Statutes at the rate provided in subsection (1) above.

Appendix E

Except for the provisions of KRS 138.351, 141.044(2), 141.235(3), and subsection (3) of this section, interest authorized under this subsection shall begin to accrue sixty (60) days after the due date of the return or the date the tax was paid, whichever is later, and in no case shall interest be paid in an amount less than five dollars ($5).

(3) Effective for refund claims filed on or after July 15, 1992, if any overpayment of the tax imposed under KRS Chapter 141 results from a carryback of a net operating loss or a net capital loss, the overpayment shall be deemed to have been made on the date the claim for refund was filed. Interest authorized under subsection (2) of this section shall begin to accrue ninety (90) days from the date the claim for refund was filed.

Appendix E

TITLE XI. REVENUE AND TAXATION
CHAPTER 131. REVENUE CABINET
GENERAL PROVISIONS

KRS § 131.183 (1998)

§ 131.183. Tax interest rate

(1) All taxes payable to the Commonwealth not paid at the time prescribed by statute shall accrue interest at the tax interest rate. The tax interest rate for tax liabilities that are assessed on or after July 1, 1982, shall be sixteen percent (16%). This tax interest rate shall apply until January 1, 1983, when the tax interest rate shall be adjusted as provided in this section. The secretary of revenue shall adjust the tax interest rate not later than November 15 of any year, beginning in 1982, if the adjusted prime rate charged by banks during October of that year, rounded to the nearest full percent, is at least one (1) percentage point more or less than the tax interest rate which is then in effect. The tax interest rate shall be equal to the adjusted prime rate charged by banks rounded to the nearest full percent, and shall become effective on January 1 of the immediately succeeding year.

(2) Interest shall be allowed and paid upon any overpayment in respect of any of the taxes provided for in Chapters 131, 132, 134, 136, 137, 138, 139, 140, 141, 142, 143, 143A, and 243 of the Kentucky Revised Statutes at the rate provided in subsection (1) above. Except for the provisions of KRS 138.351, 141.044(2),

141.235(3), and subsection (3) of this section, interest authorized under this subsection shall begin to accrue sixty (60) days after the due date of the return or the date the tax was paid, whichever is later, and in no case shall interest be paid in an amount less than five dollars ($5).

(3) Effective for refund claims filed on or after July 15, 1992, if any overpayment of the tax imposed under KRS Chapter 141 results from a carryback of a net operating loss or a net capital loss, the overpayment shall be deemed to have been made on the date the claim for refund was filed. Interest authorized under subsection (2) of this section shall begin to accrue ninety (90) days from the date the claim for refund was filed.

(4) No interest shall be allowed or paid on any sales tax refund as provided by KRS 139.536.

Appendix E

TITLE XI. REVENUE AND TAXATION
CHAPTER 134. PAYMENT, COLLECTION, AND REFUND OF TAXES

KRS § 134.580 (Michie 1993)

§ 134.580. "Agency" defined -- Refund of taxes, other than ad valorem and unconstitutional taxes

(1) As used in this section, unless the context requires otherwise, "agency" means the agency of state government which administers the tax to be refunded or credited.

(2) When money has been paid into the State Treasury in payment of any state taxes, except ad valorem taxes, whether payment was made voluntarily or involuntarily, the appropriate agency shall authorize refunds or credits to the person who paid the tax, or to his heirs, personal representatives or assigns, of any overpayment of tax and any payment where no tax was due. When a bona fide controversy exists between the agency and the taxpayer as to the liability of the taxpayer for the payment of tax claimed to be due by the agency, the taxpayer may pay the amount claimed by the agency to be due, and if an appeal is taken by the taxpayer from the ruling of the agency within the time provided by KRS 131.340 and it is finally adjudged that the taxpayer was not liable for the payment of the tax or any part thereof, the agency shall authorize the refund or credit as the Kentucky Board of Tax Appeals or courts may direct.

(3) Refunds or credits shall be authorized with interest as provided in KRS 131.183. The refunds authorized by this section shall be made in the same manner as other claims on the State Treasury are paid. They shall not be charged against any appropriation, but shall be deducted from tax receipts for the current fiscal year.

(4) Nothing in this section shall be construed to authorize the agency to make or cause to be made any refund except within four (4) years of the due date of the return or the date the money was paid into the State Treasury whichever is the later, except that, in any case where the assessment period has been extended by written agreement between the taxpayer and the cabinet, the limitation contained in this subsection shall be extended accordingly. Nothing in this section shall be construed as requiring the agency to authorize any refund or credit to a taxpayer without demand from the taxpayer, if in the opinion of the agency the cost to the state of authorizing the refund or credit would be greater than the amount that should be refunded or credited.

(5) The terms "overpayment" and "payment where no tax was due," as used in this section, shall be construed as referring to tax liability under the terms of the applicable statute without reference to the constitutionality of the statute. This section shall not apply to any case in which the statute may be held unconstitutional, either in whole or in part.

(6) In cases in which a statute has been held unconstitutional, taxes paid thereunder may be refunded to the extent provided by KRS 134.590, and by the statute held unconstitutional.

Appendix E

TITLE XI. REVENUE AND TAXATION CHAPTER 134. PAYMENT, COLLECTION, AND REFUND OF TAXES

KRS § 134.580 (Michie 1996)

§ 134.580. Refund of taxes, other than ad valorem and unconstitutional taxes

(1) As used in this section, unless the context requires otherwise:

(a) "Agency" means the agency of state government which administers the tax to be refunded or credited.

(b) "Overpayment" or "payment where no tax was due" means the tax liability under the terms of the applicable statute without reference to the constitutionality of the statute.

(2) When money has been paid into the State Treasury in payment of any state taxes, except ad valorem taxes, whether payment was made voluntarily or involuntarily, the appropriate agency shall authorize refunds or credits to the person who paid the tax, or to his heirs, personal representatives or assigns, of any overpayment of tax and any payment where no tax was due. When a bona fide controversy exists between the agency and the taxpayer as to the liability of the taxpayer for the payment of tax claimed to be due by the agency, the taxpayer may pay the amount claimed by the agency to be due, and if an appeal is taken by the taxpayer from

the ruling of the agency within the time provided by KRS 131.340 and it is finally adjudged that the taxpayer was not liable for the payment of the tax or any part thereof, the agency shall authorize the refund or credit as the Kentucky Board of Tax Appeals or courts may direct.

(3) Refunds or credits shall be authorized with interest as provided in KRS 131.183. The refunds authorized by this section shall be made in the same manner as other claims on the State Treasury are paid. They shall not be charged against any appropriation, but shall be deducted from tax receipts for the current fiscal year.

(4) Nothing in this section shall be construed to authorize the agency to make or cause to be made any refund except within four (4) years of the date prescribed by law for the filing of a return inlcuding any extension of time for filing the return, or the date the money was paid into the State Treasury, whichever is the later, except in any case where the assessment period has been extended by written agreement between the taxpayer and the cabinet, the limitation contained in this subsection shall be extended accordingly. Nothing in this section shall be construed as requiring the agency to authorize any refund or credit to a taxpayer without demand from the taxpayer, if in the opinion of the agency the cost to the state of authorizing the refund or credit would be greater than the amount that should be refunded or credited.

(5) This section shall not apply to any case in which the statute may be held unconstitutional, either in whole or in part.

(6) In cases in which a statute has been held unconstitutional, taxes paid thereunder may be refunded to the extent provided by KRS 134.590, and by the statute held unconstitutional.

Appendix E

TITLE XI. REVENUE AND TAXATION
CHAPTER 141. INCOME TAXES

KRS § 141.040 (Michie 1993)

§ 141.040. Corporation income tax -- Exemption -- Rate.

(1) Every corporation organized under the laws of this state, every corporation having its commercial domicile as defined in KRS 141.120(1)(b) in this state, and every foreign corporation owning or leasing property located in this state or having one (1) or more individuals receiving compensation as defined in KRS 141.120(8)(b) in this state, except those corporations listed in paragraphs (a) to (i) of this subsection, shall pay for each taxable year a tax to be computed by the taxpayer on taxable net income at the rates specified in subsections (2), (3), and (4) of this section:

(a) S corporations;

(b) State and national banks and trust companies, except bankers' banks organized under KRS 287.135;

(c) Savings and loan associations organized under the laws of this state and under the laws of the United States and making loans to members only;

(d) Banks for cooperatives;

(e) Production credit associations;

(f) Insurance companies, including farmers or other mutual hail, cyclone, windstorm, or fire insurance companies, insurers, and reciprocal underwriters;

(g) Corporations exempt under Section 501 of the Internal Revenue Code;

(h) Religious, educational, charitable, or like corporations not organized or conducted for pecuniary profit; and

(i) Corporations having no individuals receiving compensation as defined in KRS 141.120(8)(b) in this state, and whose only owned or leased property located in this state is located at the premises of a printer with which it has contracted for printing, if such property consists of the final printed product, property which becomes a part of the final printed product, or copy from which the printed product is produced.

(2) For tax years ending before January 1, 1990, the following rates shall apply:

(a) Three percent (3%) of the first twenty-five thousand dollars ($25,000) of taxable net income;

(b) Four percent (4%) of the amount of taxable net income in excess of twenty-five thousand dollars ($25,000), but not in excess of fifty thousand dollars ($50,000);

(c) Five percent (5%) of the amount of taxable net income in excess of fifty thousand dollars ($50,000), but not in excess of one hundred thousand dollars ($100,000);

(d) Six percent (6%) of the amount of taxable net income in excess of one hundred thousand dollars ($100,000), but not in excess of two hundred fifty thousand dollars ($250,000); and

(e) Seven and twenty-five one hundredths percent (7.25%) of the amount of taxable net income in excess of two hundred fifty thousand dollars ($250,000).

(3) For tax years beginning after December 31, 1989, the following rates shall apply:

(a) Four percent (4%) of the first twenty-five thousand dollars ($25,000) of taxable net income;

(b) Five percent (5%) of the amount of taxable net income in excess of twenty-five thousand dollars ($25,000) but not in excess of fifty thousand dollars ($50,000);

(c) Six percent (6%) of the amount of taxable net income in excess of fifty thousand dollars ($50,000), but not in excess of one hundred thousand dollars ($100,000);

(d) Seven percent (7%) of the amount of taxable net income in excess of one hundred thousand dollars ($100,000), but not in excess of two hundred fifty thousand dollars ($250,000); and

(e) Eight and twenty-five one hundredths percent (8.25%) of the amount of taxable net income in excess of two hundred fifty thousand dollars ($250,000).

(4) For tax years beginning before January 1, 1990, and ending after December 31, 1989, the tax shall be the sum of the amounts determined in paragraphs (a) and (b) as follows:

(a) Apply the tax rates in subsection (2) of this section to the taxable net income for the year and multiply the result by a fraction, the numerator of which is the number of days from the first day of the taxable year through December 31, 1989, and the denominator of which is the total number of days of the taxable year; and

(b) Apply the tax rates in subsection (3) of this section to the taxable net income for

the year and multiply the result by a fraction, the numerator of which is the number of days from January 1, 1990, through the last day of the taxable year and the denominator of which is the total number of days of the taxable year.

(5) Every S corporation shall pay the tax imposed under subsection (1) of this section whenever the net capital gain of such corporation exceeds twenty-five thousand dollars ($25,000), and exceeds fifty percent (50%) of its taxable income for the taxable year and its taxable income for such year exceeds twenty-five thousand dollars ($25,000). The tax imposed by this subsection shall be the lower of:

(a) The tax determined by applying the rates in this section to the capital gains, in excess of twenty-five thousand dollars ($25,000), determined under the Internal Revenue Code; or

(b) The tax determined by applying the rates in this section to the taxable income, in excess of twenty-five thousand dollars ($25,000);

In no event shall the tax levied by this subsection apply if Section 1374 of the Internal Revenue Code would exempt such capital gains from federal income tax.

Appendix E

TITLE XI. REVENUE AND TAXATION
CHAPTER 141. INCOME TAXES

KRS § 141.040 (Michie 1996)

§ 141.040. Corporation income tax -- Exemption -- Rate.

(1) Every corporation organized under the laws of this state, every corporation having its commercial domicile as defined in KRS 141.120(1)(b) in this state, and every foreign corporation owning or leasing property located in this state or having one (1) or more individuals receiving compensation as defined in KRS 141.120(8)(b) in this state, except those corporations listed in paragraphs (a) to (i) of this subsection, shall pay for each taxable year a tax to be computed by the taxpayer on taxable net income at the rates specified in subsections (2), (3), and (4) of this section:

(a) S corporations;

(b) Financial institutions, as defined in KRS 136.500, except bankers banks organized under KRS 287.135;

(c) Savings and loan associations organized under the laws of this state and under the laws of the United States and making loans to members only;

(d) Banks for cooperatives;

(e) Production credit associations;

(f) Insurance companies, including farmers or other mutual hail, cyclone, windstorm, or fire insurance companies, insurers, and reciprocal underwriters;

(g) Corporations exempt under Section 501 of the Internal Revenue Code;

(h) Religious, educational, charitable, or like corporations not organized or conducted for pecuniary profit; and

(i) Corporations having no individuals receiving compensation as defined in KRS 141.120(8)(b) in this state, and whose only owned or leased property located in this state is located at the premises of a printer with which it has contracted for printing, if such property consists of the final printed product, property which becomes a part of the final printed product, or copy from which the printed product is produced.

(2) For tax years ending before January 1, 1990, the following rates shall apply:

(a) Three percent (3%) of the first twenty-five thousand dollars ($25,000) of taxable net income;

(b) Four percent (4%) of the amount of taxable net income in excess of twenty-five thousand dollars ($25,000), but not in excess of fifty thousand dollars ($50,000);

(c) Five percent (5%) of the amount of taxable net income in excess of fifty thousand dollars ($50,000), but not in excess of one hundred thousand dollars ($100,000);

(d) Six percent (6%) of the amount of taxable net income in excess of one hundred thousand dollars ($100,000), but not in excess of two hundred fifty thousand dollars ($250,000); and

(e) Seven and twenty-five one hundredths percent (7.25%) of the amount of taxable net income in excess of two hundred fifty thousand dollars ($250,000).

(3) For tax years beginning after December 31, 1989, the following rates shall apply:

(a) Four percent (4%) of the first twenty-five thousand dollars ($25,000) of taxable net income;

(b) Five percent (5%) of the amount of taxable net income in excess of twenty-five thousand dollars ($25,000) but not in excess of fifty thousand dollars ($50,000);

(c) Six percent (6%) of the amount of taxable net income in excess of fifty thousand dollars ($50,000), but not in excess of one hundred thousand dollars ($100,000);

(d) Seven percent (7%) of the amount of taxable net income in excess of one hundred thousand dollars ($100,000), but not in excess of two hundred fifty thousand dollars ($250,000); and

(e) Eight and twenty-five one hundredths percent (8.25%) of the amount of taxable net income in excess of two hundred fifty thousand dollars ($250,000).

(4) For tax years beginning before January 1, 1990, and ending after December 31, 1989, the tax shall be the sum of the amounts determined in paragraphs (a) and (b) as follows:

(a) Apply the tax rates in subsection (2) of this section to the taxable net income for the year and multiply the result by a fraction, the numerator of which is the number of days from the first day of the taxable year through December 31, 1989, and the denominator of which is the total number of days of the taxable year; and

(b) Apply the tax rates in subsection (3) of this section to the taxable net income for

the year and multiply the result by a fraction, the numerator of which is the number of days from January 1, 1990, through the last day of the taxable year and the denominator of which is the total number of days of the taxable year.

(5) Every S corporation shall pay the tax imposed under subsection (1) of this section whenever the net capital gain of such corporation exceeds twenty-five thousand dollars ($25,000), and exceeds fifty percent (50%) of its taxable income for the taxable year and its taxable income for such year exceeds twenty-five thousand dollars ($25,000). The tax imposed by this subsection shall be the lower of:

(a) The tax determined by applying the rates in this section to the capital gains, in excess of twenty-five thousand dollars ($25,000), determined under the Internal Revenue Code; or

(b) The tax determined by applying the rates in this section to the taxable income, in excess of twenty-five thousand dollars ($25,000);

In no event shall the tax levied by this subsection apply if Section 1374 of the Internal Revenue Code would exempt such capital gains from federal income tax.

Appendix E

TITLE XI. REVENUE AND TAXATION
CHAPTER 141. INCOME TAXES

KRS § 141.235 (Michie 1993)

§ 141.235. Action interfering with collection or payment prohibited — Limitation on refund of taxes.

(1) No suit shall be maintained in any court to restrain or delay the collection or payment of the tax levied by this chapter.

(2) Any tax collected pursuant to the provisions of KRS Chapter 141, may be refunded or credited in the manner provided in KRS 134.580, provided that the claim for refund or credit is made within four (4) years of the due date of the return or the date the tax was paid, whichever is later, except that, in any case where the assessment period contained in KRS 141.210 has been extended by an agreement between the taxpayer and the cabinet, the limitation contained in this subsection shall be extended accordingly.

(3) Overpayments of taxes collected pursuant to KRS 141.300, 141.310, or 141.315 shall be refunded or credited with interest at the tax interest rate as defined in KRS 131.010(6). The interest shall not begin to accrue until ninety (90) days after the overpayment is made, the return was filed, or the due date of the return, whichever is later.

Appendix E

(4) Exclusive authority to refund or credit overpayments of taxes collected pursuant to this chapter is vested in the secretary or his authorized agent. Amounts directed to be refunded shall be paid out of the general fund.

Appendix E

TITLE XI. REVENUE AND TAXATION
CHAPTER 141. INCOME TAXES

KRS § 141.235 (Michie 1994)

§ 141.235. Action interfering with collection or payment prohibited — Limitation on refund of taxes.

(1) No suit shall be maintained in any court to restrain or delay the collection or payment of the tax levied by this chapter.

(2) Any tax collected pursuant to the provisions of this chapter may be refunded or credited in accordance with the provisions of KRS 134.580, provided that the claim for refund or credit is made within four (4) years of the last day prescribed by lawfor the filing of the return or the date the tax was paid, whichever is later, except that, except that;

> (a) In any case where the assessment period contained in KRS 141.210 has been extended by an agreement between the taxpayer and the cabinet, the limitation contained in this subsection shall be extended accordingly.
>
> (b) If the claim for refund or credit relates directly to adjustments resulting from a federal audit, the taxpayer shall file a claim for refund or credit within the time provided

for in this subsection or six (6) months from the conclusion of the federal audit, whichever is later.

(c) If the claim for refund or credit relates to an overpayment attributable to a net operating loss carryback or capital loss carryback, resulting from a loss which occurs in a taxable year beginning after December 31, 1993, the claim for refund or credit shall be filed within the times prescribed in this subsection for the taxable year of the net operating loss or capital loss which results in the carryback.

For the purposes of this subsection and subsection (3) of this section, a return filed before the last day prescribed by law for filing the return shall be considered as filed on the last day. For taxable years beginning after December 31, 1993, any extension of time granted for filing the return shall also be considered as extending the last day prescribed by law for filing the return.

(3) Overpayments of taxes collected pursuant to KRS 141.300, 141.310, or 141.315 shall be refunded or credited with interest at the tax interest rate as defined in KRS 131.010(6). The interest shall not begin to accrue until ninety (90) days after the tax was paid, the return was filed, or the last day prescribed by law for filing the return, whichever is later.

Appendix E

(4) Exclusive authority to refund or credit overpayments of taxes collected pursuant to this chapter is vested in the secretary or his authorized agent. Amounts directed to be refunded shall be paid out of the general fund.

Appendix E

TITLE XI. REVENUE AND TAXATION
CHAPTER 141. INCOME TAXES

KRS § 141.235 (Michie 1996)

§ 141.235. Action interfering with collection or payment prohibited — Limitation on refund of taxes.

(1) No suit shall be maintained in any court to restrain or delay the collection or payment of the tax levied by this chapter.

(2) Any tax collected pursuant to the provisions of this chapter may be refunded or credited in accordance with the provisions of KRS 134.580, except that:

> (a) In any case where the assessment period contained in KRS 141.210 has been extended by an agreement between the taxpayer and the cabinet, the limitation contained in this subsection shall be extended accordingly.
>
> (b) If the claim for refund or credit relates directly to adjustments resulting from a federal audit, the taxpayer shall file a claim for refund or credit within the time provided for in this subsection or six (6) months from the conclusion of the federal audit, whichever is later.

(c) If the claim for refund or credit relates to an overpayment attributable to a net operating loss carryback or capital loss carryback, resulting from a loss which occurs in a taxable year beginning after December 31, 1993, the claim for refund or credit shall be filed within the times prescribed in this subsection for the taxable year of the net operating loss or capital loss which results in the carryback.

For the purposes of this subsection and subsection (3) of this section, a return filed before the last day prescribed by law for filing the return shall be considered as filed on the last day.

(3) Overpayments of taxes collected pursuant to KRS 141.300, 141.310, or 141.315 shall be refunded or credited with interest at the tax interest rate as defined in KRS 131.010(6). The interest shall not begin to accrue until ninety (90) days after the tax was paid, the return was filed, or the last day prescribed by law for filing the return, whichever is later.

(4) Exclusive authority to refund or credit overpayments of taxes collected pursuant to this chapter is vested in the secretary or his authorized agent. Amounts directed to be refunded shall be paid out of the general fund.

APPENDIX F — BALDWIN'S CERTIFIED VERSION KRS KENTUCKY REVISED STATUTES AND RULES SERVICE, 2008 ACTS ISSUE

Acts of the 2008 Regular and First Extraordinary Session of the General Assembly with Official KRS Numbers Designated by the Reviser of Statutes

TAXATION—FINES AND PENALTIES
SCHOOLS AND SCHOOL DISTRICTS

CHAPTER 132

HB 704

AN ACT relating to fiscal matters and declaring an emergency. *Be it enacted by the General Assembly of the Commonwealth of Kentucky.*

* * *

Section 8. KRS 131.183 is amended to read as follows:

131.183

(1) *(a)* All taxes payable to the Commonwealth not paid at the time prescribed by statute shall accrued interest at the tax interest rate. ~~The tax interest rate for tax liabilities that are assessed on or after July 1, 1982, shall be sixteen percent (16%). This tax interest rate shall apply until January 1, 1983, when the tax interest rate shall be adjusted as provided in this section. The commissioner of revenue shall adjust the tax interest rate not later than November 15 of any year,~~

~~beginning in 1982, if the adjusted prime rate charged by banks during October of that year, rounded to the nearest full percent, is at least one(1) percentage point more or less than the tax interest rate which is then in effect.~~

(b) The tax interest rate shall be equal to the adjusted prime rate charged by banks rounded to the nearest full percent *as adjusted by subsection (2) of this section.*

(c) The commissioner of revenue shall adjust the tax interest rate not later than November 15 of each year if the adjusted prime rate charged by banks during October of that year, rounded to the nearest full percent, is at least one (1) percentage point more of less than the tax interest rate which is then in effect. The adjusted tax interest rate, ~~and~~ shall become effective on January 1 of the immediately succeeding year.

(2) *(a) 1. All taxes payable to the Commonwealth that have not been paid at the time prescribed by statute shall accrue interest at the tax interest rate as determined in accordance with subsection (1) of this section until May 1, 2008.*

2. Beginning on May 1, 2008, all taxes payable to the Commonwealth that have not been paid at the time prescribed by statute shall accrue interest at the tax interest rate as determined in accordance with subsection (1) of this section plus two percent (2%).

(b) 1. Interest shall be allowed and paid upon any overpayment *as defined in KRS 134.580* in respect of any of the taxes provided for in Chapters 131, 132, 134, 136, 137, 138, 139, 140, 141, 142, 143, 143A, and 243 of the Kentucky Revised Statutes and KRS 160.613 and 160.614 at the rate provided in subsection (1) *of this section until May 1, 2008*~~above~~.

2. Beginning on May 1, 2008, interest shall be allowed and paid upon any overpayment as defined in KRS 134.580 at the rate provided in subsection (1) of this section minus two percent (2%).

3. Effective for refunds issued after the effective date of this Act, except for the provisions of KRS 138.351, 141.044(2), 141.235(3), and subsection (3) of this section, interest authorized under this subsection shall begin to accrue sixty (60) days after *the latest of:*

a. The due date of the return;
b. The date the return was filed; ~~or~~
c. The date the tax was paid;
d. The last day prescribed by law for filing the return; or
e. The date an amended return claiming a refund is filed.;
~~whichever is later, and~~

(c) In no case shall interest be paid in an amount less than five dollars ($5).

(3) Effective for refund claims filed on or after July 15, 1992, if any overpayment of the tax imposed under KRS Chapter 141 results from a carryback of a net operating loss or a net capital loss, the overpayment shall be deemed to have been made on the date the claim for refund was filed. Interest authorized under subsection (2) of this section shall begin to accrue ninety (90) days from the date the claim for refund was filed.

(4) No interest shall be allowed or paid on any sales tax refund as provided by KRS 139.536.

* * *

Section 10. KRS 141.235 is amended to read as follows:

141.235

(1) No suit shall be maintained in any court to restrain or delay the collection or payment of the tax levied by this chapter.

(2) Any tax collected pursuant to the provisions of this chapter may be refunded or credited in accordance with the provisions of KRS 134.580, except that:

(a) In any case where the assessment period contained in KRS 141.210 has been extended by an agreement between the taxpayer and the department, the limitation contained in this subsection shall be extended accordingly.

(b) If the claim for refund or credit relates directly to adjustments resulting from a federal audit, the taxpayer shall file a claim for refund or credit within the time provided for in this subsection or six (6) months from the conclusion of the federal audit, whichever is later.

(c) If the claim for refund or credit relates to an overpayment attributable to a net operating loss carryback or capital loss carryback, resulting from a loss which occurs in a taxable year beginning after December 31, 1993, the claim for refund or credit shall be filed within the times prescribed in this subsection for the taxable year of the net operating loss or capital loss which results in the carryback.

For the purposes of this subsection and subsection (3) of this section, a return filed before the last day prescribed by law for filing the return shall be considered as filed on the last day.

(3) Overpayments *as defined in KRS 134.580* of taxes collected pursuant to KRS 141.300, 141.310, or 141.315 shall be refunded or credited with interest at the tax interest rate as defined in KRS 131.010(6). *Effective for refunds issued after the effective date of this Act,* the interest shall not begin to accrue until ninety (90) days after the *latest of:*

(a) The due date of the return;

(b) The date the return was filed;

(c) The date the tax was filed;

(d) ~~The return was filed, or the~~ last day prescribed by law for filing the return; *or*

(e) The date an amended return *claiming a refund is filed*~~, whichever is later~~.

(4) Exclusive authority to refund or credit overpayments of taxes collected pursuant to this chapter is vested in the commissioner or his authorized agent. Amounts directed to be refunded shall be paid out of the general fund.

* * *

Section 11. KRS 134.580 is amended to read as follows:

134.580

(1) As used in this section, unless the context requires otherwise:

(a) "Agency" means the agency of state government which administers the tax to be refunded or credited.

(b) "Overpayment" or "payment where no tax was due" means the *excess of the tax payments made over the correct* tax liability *determined* under the terms of the applicable statute without reference to the constitutionality of the statute.

(2) When money has been paid into the State Treasury in payment of any state taxes, except ad valorem taxes, whether payment was made voluntarily or involuntarily, the appropriate agency shall authorize refunds to the person who paid the tax, or to his heirs, personal representatives or assigns, of any overpayment of tax and any payment where no tax was due. When a bona fide controversy exists between the agency and the taxpayer as to the liability of the taxpayer for the payment of tax claimed to be due by the agency, the taxpayer may pay the amount claimed by the agency to be due, and if an appeal is taken by the taxpayer from the ruling of the agency within the time provided by KRS 131.340 and it is finally adjudged that the taxpayer was not liable for the payment of the tax or any part thereof, the agency shall authorize the refund or credit as the Kentucky Board of Tax Appeals or courts may direct.

(3) No refund shall be made unless each taxpayer individually files an application or claim for the refund within four (4) years from the date payment was made. Each claim or application for a refund shall be in writing and state the specific grounds upon which it is based. Denials of refund claims or applications may be protested and appealed in accordance with KRS 131.110 and 131.340.

(4) Refunds shall be authorized with interest as provided in KRS 131.183. The refunds authorized by this section shall be made in the same manner as other claims on the State Treasury are paid. They shall not be charged

against any appropriation, but shall be deducted from tax receipts for the current fiscal year.

(5) Nothing in this section shall be construed to authorize the agency to make or cause to be made any refund except within four (4) years of the date prescribed by law for filing of a return including any extension of time for the filing the return, or the date the money was paid into the State Treasury, whichever is the later, except in any case where the assessment period has been extended by written agreement between the taxpayer and the department, the limitation contained in this subsection shall be extended accordingly. Nothing in this section shall be construed as requiring the agency to authorize any refund to a taxpayer without demand from the taxpayer, if in the opinion of the agency the cost to the state of authorizing the refund would be greater than the amount that should be refunded or credited.

(6) This section shall not apply to any case in which the statute may be held unconstitutional, either in whole or in part.

(7) In cases in which a statute has been held unconstitutional, taxes paid thereunder may be refunded to the extent provided by KRS 134.590, and by the statute held unconstitutional.

(8) No person shall secure a refund of motor fuels tax under KRS 134.580 unless the person holds an unrevoked refund permit issued by the department before the purchase of gasoline or special fuels and that

permit entitles the person to apply for a refund under KRS 138.344 to 138.355.

(9) Notwithstanding any provision of the Kentucky Revised Statutes to the contrary:

(a) The Commonwealth hereby revokes and withdraws its consent to suit in any forum whatsoever on any claim for recovery, refund, or credit of any tax overpayment for any taxable year ending before December 31, 1995, made by an amended return or any other method after December 22, 1994, and based on a change from any initially filed separate return or returns to a combined return under the unitary business concept or to a consolidated return. No such claim shall be effective or recognized for any purpose.

(b) Any stated or implied consent for the Commonwealth of Kentucky, or any agent or officer of the Commonwealth of Kentucky, to be sued by any person for any legal, equitable, or other relief with respect to any claim for recovery, refund, or credit of any tax overpayment for any taxable year ending before December 31, 1995, made by an amended return or any other method after December 22, 1994, and based on a change from any initially filed separate return or returns to a combined return under the unitary business concept or to a consolidated return, is hereby withdrawn.

(c) The provisions of this subsection shall apply retroactively for all taxable years ending before December 31, 1995, and shall apply to all claims for such

taxable years pending in any judicial or administrative forum.

(10) Notwithstanding any provision of the Kentucky Revised Statutes to the contrary:

(a) No money shall be drawn from the State Treasury for the payment of any claim for recovery, refund, or credit of any tax overpayment for any taxable year ending before December 31, 1995, made by an amended return or any other method after December 22, 1994, and based on a change from any initially filed separate return or returns to a combined return under the unitary business concept or to a consolidated return.

(b) No provision of the Kentucky Revised Statutes shall constitute an appropriation or mandated appropriation for the payment of any claim for recovery, refund, or credit of any tax overpayment for any taxable year ending before December 31, 1995, made by an amended return or any other method after December 22, 1994, and based on a change from any initially filed separate return or returns to a combined return under the unitary business concept or to a consolidated return.

* * *

Section 15. The provisions of Sections 8 to 11 of this Act shall apply retroactively to all outstanding refund claims for taxable years ending prior to the effective date of this Act and shall apply to all claims for those taxable years pending in any judicial or administrative forum.

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* * *

Section 17. Whereas it is necessary to expediently address issues originally addressed in 2006 Ky. Acts ch. 252, an emergency is declared to exist, and Sections 1 to 6 and 8 to 15 of this Act takes effect upon its passage and approval by the Governor or upon its otherwise becoming a law.

* * *

Approved April 24, 2008.

Appendix F

COMMONWEALTH OF KENTUCKY
STATE FISCAL NOTE STATEMENT

GENERAL ASSEMBLY
2008 REGULAR SESSION

LEGISLATIVE RESEARCH COMMISSION
2008-2010 INTERIM

MEASURE

(x) 2008 BR No. 1831 (x) House Bill No. 704 GA

( ) Resolution No. _____ ( ) Amendment No. _____

SUBJECT/TITLE AN ACT relating to revenue and taxation.

SPONSOR Rep. H. Moberly

NOTE SUMMARY

Fiscal Analysis: ___ Impact X No Impact ___ Indeterminable Impact

Level(s) of Impact: ___ State ___ Local ___ Federal

Budget Unit(s) Impact _____

Fund(s) Impact: X General ___ Road ___ Federal

_____ Restricted Agency (Type) _____ (Other)

FISCAL SUMMARY

Fiscal Estimates	2007-2008	2008-2009	2009-2010	Future Annual Rate of Change
Revenues (+/-)				
Expenditures (+/-)				
Net Effect			No Impact	No Impact

MEASURE'S PURPOSE:

This bill is the Department of Revenue's housekeeping legislation. It contains several changes that bring statutes into alignment with federal law, judicial action, and technology changes. Three additional components were added by amendment and are included in the GA version; First, the earmarking of one penny of the cigarette tax for cancer research. This has been directed in the budget bill for several years; this change codifies that earmark as permanent law. Second, the motor fuels tax will increase under operation of current statute by 1.5 cents on July 1, 2008. The amount of that increase that is retained at the state level and not available for local government revenue sharing is limited by this bill. The amount that is retained at the state level is 1.4 cents, leaving 0.1 cent to be revenue shared with local governments. The third change clarifies that importers of cigarettes are required to file the same monthly reports that are filed by manufacturers of cigarettes.

PROVISION/MECHANICS:

Amend KRS 136.392 to codify several court decisions; amend KRS 138.195 to clarify that manufacturersand first importers are to submit to the department monthly reports of all shipments of cigarettes, other tobacco products, or snuff to persons within this state; amend KRS 141.160 to clarify that income tax returns of cooperatives are to be made on September 15 in each year, unless the return is prepared on a fiscal year basis; amend KRS 160.6156 to provide that a utility service provider shall not be entitled to a refund or credit of taxes paid, unless the provider refunds or credits its related customers the amount of overpayment made to the department; amend KRS 160.6157 to allow the department to issue a penalty on a utility service provider who erroneously bills a customer after being notified by the department of the error in an amount equal to $25 per subsequent error, not to exceed $10,000 per month; amend KRS 160.6158 to allow the penalty to be waived based on reasonable cause. KRS 138.140 is

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amended to codify the earmark for cancer research, and KRS 138.220 is amended to specify the amount of the motor fuels tax that would not be revenue shared.

FISCAL EXPLANATION:

There is no expected fiscal impact from this bill. The changes represent current practice based on federal and judicial guidelines, and to align with currently available technology. The amendments included in the GA version also contain no expected fiscal impact. The cigarette tax earmark has been done for several years through budget bill language, and the motor fuels tax does not increase or decrease because of this language change.

DATA SOURCE(S) Dept. of Revenue, OSBD, LRC staff.

NOTE NO. 131.1 PREPARER John Scott REVIEW LBH DATE 03-14-08

APPENDIX G — BALDWIN'S CERTIFIED VERSION KRS KENTUCKY REVISED STATUTES AND RULES SERVICE, 2009 ACTS ISSUE

Acts of the 2009 Regular Session of the General Assembly with Official KRS Numbers Designated by the Reviser of Statutes

* * *

TAXATION—CHARITABLE AUCTION

CHAPTER 86

HB 216

AN ACT relating to fiscal matter and declaring an emergency. *Be it enacted by the General Assembly of the Commonwealth of Kentucky.*

* * *

Section 7. KRS 131.183 is repealed and reenacted to read as follows:

131.183

(1) (a) All taxes payable to the Commonwealth not paid at the time prescribed by statute shall accrue interest at the tax interest rate.

(b) The tax interest rate shall be equal to the adjusted prime rate charged by banks rounded to the nearest full percent as adjusted by subsection (2) of this section.

(c) The commissioner of revenue shall adjust the tax interest rate not later than November 15 of each year if the adjusted prime rate charged by banks during October of that year, rounded to the nearest full percent, is at least one (1) percentage point more of less than the tax interest rate which is then in effect. The adjusted tax interest rate shall become effective on January 1 of the immediately succeeding year.

(2) (a) 1. All taxes payable to the Commonwealth that have not been paid at the time prescribed by statute shall accrue interest at the tax interest rate as determined in accordance with subsection (1) of this section until May 1, 2008.

2. Beginning on May 1, 2008, all taxes payable to the Commonwealth that have not been paid at the time prescribed by statute shall accrue interest at the tax interest rate as determined in accordance with subsection (1) of this section plus two percent (2%).

(b) 1. Interest shall be allowed and paid upon any overpayment as defined in KRS 134.580 in respect of any of the taxes provided for in Chapters 131, 132, 134, 136, 137, 138, 139, 140, 141, 142, 143, 143A, and 243 of the Kentucky Revised Statutes and KRS 160.613 and 160.614 at the rate provided in subsection (1) of this section until May 1, 2008.

2. Beginning on May 1, 2008, interest shall be allowed and paid upon any overpayment as defined in KRS 134.580 at the rate provided in subsection (1) of this section minus two percent (2%).

3. Effective for refunds issued after April 24, 2008, except for the provisions of KRS 138.351, 141.044(2), 141.235(3), and subsection (3) of this section, interest authorized under this subsection shall begin to accrue sixty (60) days after the latest of:

a. The due date of the return;
b. The date the return was filed;
c. The date the tax was paid;
d. The last day prescribed by law for filing the return; or
e. The date an amended return claiming a refund is filed.

(c) In no case shall interest be paid in an amount less than five dollars ($5).

(3) Effective for refund claims filed on or after July 15, 1992, if any overpayment of the tax imposed under KRS Chapter 141 results from a carryback of a net operating loss or a net capital loss, the overpayment shall be deemed to have been made on the date the claim for refund was filed. Interest authorized under subsection (2) of this section shall begin to accrue ninety (90) days from the date the claim for refund was filed.

(4) No interest shall be allowed or paid on any sales tax refund as provided by KRS 139.536.

* * *

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Section 9. KRS 141.235 is repealed and reenacted to read as follows:

141.235

(1) No suit shall be maintained in any court to restrain or delay the collection or payment of the tax levied by this chapter.

(2) Any tax collected pursuant to the provisions of this chapter may be refunded or credited in accordance with the provisions of KRS 134.580, except that:

(a) In any case where the assessment period contained in KRS 141.210 has been extended by an agreement between the taxpayer and the department, the limitation contained in this subsection shall be extended accordingly.

(b) If the claim for refund or credit relates directly to adjustments resulting from a federal audit, the taxpayer shall file a claim for refund or credit within the time provided for in this subsection or six (6) months from the conclusion of the federal audit, whichever is later.

(c) If the claim for refund or credit relates to an overpayment attributable to a net operating loss carryback or capital loss carryback, resulting from a loss which occurs in a taxable year beginning after December 31, 1993, the claim for refund or credit shall be filed

within the times prescribed in this subsection for the taxable year of the net operating loss or capital loss which results in the carryback.

For the purposes of this subsection and subsection (3) of this section, a return filed before the last day prescribed by law for filing the return shall be considered as filed on the last day.

(3) Overpayments as defined in KRS 134.580 of taxes collected pursuant to KRS 141.300, 141.310, or 141.315 shall be refunded or credited with interest at the tax interest rate as defined in KRS 131.010(6). Effective for refunds issued after April 24, 2008, the interest shall not begin to accrue until ninety (90) days after the latest of:

(a) The due date of the return;
(b) The date the return was filed;
(c) The date the tax was paid;
(d) The last day prescribed by law for filing the return; or
(e) The date an amended return claiming a refund is filed.

(4) Exclusive authority to refund or credit overpayments of taxes collected pursuant to this chapter is vested in the commissioner or his authorized agent. Amounts directed to be refunded shall be paid out of the general fund.

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Section 10. KRS 134.580 is repealed and reenacted to read as follows:

134.580

(1) As used in this section, unless the context requires otherwise:

(a) "Agency" means the agency of state government which administers the tax to be refunded or credited.

(b) "Overpayment" or "payment where no tax was due" means the excess of the tax payments made over the correct tax liability determined under the terms of the applicable statute without reference to the constitutionality of the statute.

(2) When money has been paid into the State Treasury in payment of any state taxes, except ad valorem taxes, whether payment was made voluntarily or involuntarily, the appropriate agency shall authorize refunds to the person who paid the tax, or to his heirs, personal representatives or assigns, of any overpayment of tax and any payment where no tax was due. When a bona fide controversy exists between the agency and the taxpayer as to the liability of the taxpayer for the payment of tax claimed to be due by the agency, the taxpayer may pay the amount claimed by the agency to be due, and if an appeal is taken by the taxpayer from the ruling of the agency within the time provided by KRS 131.340 and it is finally adjudged that the taxpayer

was not liable for the payment of the tax or any part thereof, the agency shall authorize the refund or credit as the Kentucky Board of Tax Appeals or courts may direct.

(3) No refund shall be made unless each taxpayer individually files an application or claim for the refund within four (4) years from the date payment was made. Each claim or application for a refund shall be in writing and state the specific grounds upon which it is based. Denials of refund claims or applications may be protested and appealed in accordance with KRS 131.110 and 131.340.

(4) Refunds shall be authorized with interest as provided in KRS 131.183. The refunds authorized by this section shall be made in the same manner as other claims on the State Treasury are paid. They shall not be charged against any appropriation, but shall be deducted from tax receipts for the current fiscal year.

(5) Nothing in this section shall be construed to authorize the agency to make or cause to be made any refund except within four (4) years of the date prescribed by law for the filing of a return including any extension of time for filing the return, or the date the money was paid into the State Treasury, whichever is the later, except in any case where the assessment period has been extended by written agreement between the taxpayer and the department, the limitation contained in this subsection shall be extended accordingly. Nothing in this section shall be construed as requiring the agency to

authorize any refund to a taxpayer without demand from taxpayer, if in the opinion of the agency the cost to the state of authorizing the refund would be greater than the amount that should be refunded or credited.

(6) This section shall not apply to any case in which the statute may be held unconstitutional, either in whole or in part.

(7) In cases in which a statute has been held unconstitutional, taxes paid thereunder may be refunded to the extent provided by KRS 134.590, and by the statute held unconstitutional.

(8) No person shall secure a refund of motor fuels tax under KRS 134.580 unless the person holds an unrevoked refund permit issued by the department before the purchase of gasoline or special fuels and that permit entitles the person to apply for a refund under KRS 138.344 to 138.355.

(9) Notwithstanding any provision of the Kentucky Revised Statutes to the contrary:

(a) The Commonwealth hereby revokes and withdraws its consent to suit in any forum whatsoever on any claim for recovery, refund, or credit of any tax overpayment for any taxable year ending before December 31, 1995, made by an amended return or any other method after December 22, 1994, and based on a change from any initially filed separate return or returns to a combined return under the unitary business concept

or to a consolidated return. No such claim shall be effective or recognized for any purpose.

(b) Any stated or implied consent for the Commonwealth of Kentucky, or any agent or officer of the Commonwealth of Kentucky, to be sued by any person for any legal, equitable, or other relief with respect to any claim for recovery, refund, or credit of any tax overpayment for any taxable year ending before December 31, 1995, made by an amended return or any other method after December 22, 1994, and based on a change from any initially filed separate return or returns to a combined return under the unitary business concept or to a consolidated return, is hereby withdrawn.

(c) The provisions of this subsection shall apply retroactively for all taxable years ending before December 31, 1995, and shall apply to all claims for such taxable years pending in any judicial or administrative forum.

(10) Notwithstanding any provision of the Kentucky Revised Statutes to the contrary:

(a) No money shall be drawn from the State Treasury for the payment of any claim for recovery, refund, or credit of any tax overpayment for any taxable year ending before December 31, 1995, made by an amended return or any other method after December 22, 1994, and based on a change from any initially filed separate return or returns to a combined return under the unitary business concept or to a consolidated return.

(b) No provision of the Kentucky Revised Statutes shall constitute an appropriation or mandated appropriation for the payment of any claim for recovery, refund, or credit of any tax overpayment for any taxable year ending before December 31, 1995, made by an amended return or any other method after December 22, 1994, and based on a change from any initially filed separate return or returns to a combined return under the unitary business concept or to a consolidated return.

* * *

Section 15. The provisions of Sections 7 to 10 of this Act shall apply retroactively to all outstanding refund claims for taxable years ending prior to the effective date of this Act and shall apply to all claims for those taxable years pending in any judicial or administrative forum.

* * *

Section 17. The intent of the General Assembly in repealing and reenacting KRS 136.392, 138.195, 141.160, 160.6156, 160.6157, 160.6158, 131.183, 141.044, 141.235, 134.580, 393.060, and 157.621 in Sections 1 to 12 of this Act is to affirm the amendments made to these sections in 2008 Ky. Acts ch. 132. The provisions in Sections 1 to 12 of this Act shall apply retroactively to April 24, 2008.

Section 18. To the extent that any provision included in this act is considered new language, the provisions of KRS 446.145 requiring such new language to be underlined are notwithstood.

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Section 19. Whereas it is necessary to expediently address issues originally addressed in 2006 Ky. Acts ch. 252, an emergency is declared to exist, and Sections 1 to 12 of this Act take effect upon the Act's passage and approval by the Governor or upon its otherwise becoming a law.

* * *

Approved March 24, 2009.

Appendix G

COMMONWEALTH OF KENTUCKY
STATE FISCAL NOTE STATEMENT

GENERAL ASSEMBLY
2009 REGULAR SESSION

LEGISLATIVE RESEARCH COMMISSION
2008-2010 INTERIM

MEASURE

(x) 2009 BR No. 0333 (x) House Bill No. 216 GA

( ) Resolution No. _____ ( ) Amendment No. _____

SUBJECT/TITLE AN ACT relating to fiscal matters and declaring an emergency.

SPONSOR Rep. Rick Rand

NOTE SUMMARY

Fiscal Analysis: ___ Impact _x_ No Impact ___ Indeterminable Impact

Level(s) of Impact: _x_ State ___ Local ___ Federal

Budget Unit(s) Impact _____

Fund(s) Impact: ___ General ___ Road ___ Federal

_____ Restricted Agency (Type) _____ (Other)

FISCAL SUMMARY

Fiscal Estimates	2008-2009	2009-2010	2010-2011	Future Annual Rate of Change
Revenues (+/-)	-0-	-0-	-0-	-0-
Expenditures (+/-)				
Net Effect	-0-	-0-	-0-	-0-

MEASURE'S PURPOSE:
The bill repeals and reenacts various statutes that were passed by the 08 Regular Session of the General Assembly.

PROVISION/MECHANICS:
The bill repeals and reenacts various statutes that were passed by the 08 Regular Session of the General Assembly.

FISCAL EXPLANATION:
There is no fiscal impact from this bill.

DATA SOURCE(S) LRC Staff

NOTE NO. 27.1 PREPARER John Scott REVIEW LBH DATE 3/10/09

LRC 2009-0333-HB216-GA

APPENDIX H — EXPERT OPINION OF PROFESSOR RICHARD D. POMP

Introduction

You have contacted me as the former Director of the New York Tax Study Commission and as someone who for nearly 25 years has studied, lectured, taught, published, and consulted with, and testified on behalf of, state governments, regarding issues of state taxation.

You have asked my opinion about the policies that distinguish due process nexus from commerce clause nexus. In addition, you have asked whether physical presence or metaphysical presence is more compatible with the values underlying the commerce clause. Specifically, you have asked my opinion on whether physical presence or metaphysical presence is more consistent with sound tax policy.

Your questions arise from a case involving an out-of-state corporation having no property or payroll in Kentucky, which is a partner in a Kentucky partnership. The Kentucky partnership has nexus with Kentucky under the Kentucky corporation income tax. Should the out-of-state corporation be viewed as a shareholder in a corporation, in which case the shareholder would not be viewed as having nexus with Kentucky. The Revenue Cabinet, however, apparently rejects this view.

The Revenue Cabinet requires corporate partners to include in apportionable income their distributive share of partnership business income and considers this

income to be from intangible property. The Revenue Cabinet does not take a similar position with respect to shareholders receiving dividends from corporations doing business in Kentucky. The Revenue Cabinet does not treat the factors of the partnership as flowing through to the partners.

Due Process Nexus and Commerce Clause Nexus: A Policy Overview

As background for understanding the policy considerations that are relevant in analyzing the position of the Revenue Cabinet, you have asked me the policy differences between due process nexus and commerce clause nexus. Due process nexus is concerned with the fundamental fairness of governmental activity. It requires a state to ask whether a person's connections with it are substantial enough to legitimate the state's exercise of power over that person. "Notice" or "fair warning" is the analytic touchstones of due process nexus.

In contrast, commerce clause nexus is informed by structural concerns about the effects of state taxation on the national economy. A state must ask whether its actions hinder, suppress, or unduly burden interstate commerce. Commerce clause nexus is a means for limiting state burdens on interstate commerce.

As this brief description suggests, due process nexus is a very different concept from commerce clause nexus and a person that has due process nexus with a state

does not necessarily have commerce clause nexus. The Revenue Cabinet's position regarding the taxation of an out-of-state corporate partner having no property or payroll in Kentucky raises questions concerning both types of nexus, but my opinion is limited to only the policy considerations surrounding commerce clause nexus.

There is no doubt that commerce clause nexus can be satisfied by a person's physical presence. This physical presence standard has the blessing of the U.S. Supreme Court and that of all state courts. As the name implies, physical presence or physical nexus refers to the presence in a state of tangible property or of personnel of the taxpayer. Physical nexus has a long history and tradition and provides a standard that in nearly all cases is unambiguous and easily applied. Moreover, physical presence provides a determinate solution to the issue of nexus because property or persons cannot simultaneously exist in more than one state. An out-of-state corporation that does not have any payroll or payroll in Kentucky does not have any physical presence in Kentucky.

The out-of-state corporate partner that the Revenue Cabinet seeks to tax does not have any physical presence of its own in Kentucky, and I do not believe the Revenue Cabinet is challenging that proposition. Instead, the Revenue Cabinet seems to be applying a new standard of commerce clause nexus: metaphysical nexus. The partner is physically present in Kentucky because of its interest in a partnership that is doing business in Kentucky. An interest in a partnership is intangible or metaphysical property.

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Metaphysical nexus is an incorporeal standard, which does not require that a taxpayer have any physical presence in a state. Rather, a corporation is present under this theory because of various legal relationships that exist between itself and some other person that is present in the Kentucky. In the present case, the Revenue Cabinet's position seems to be that the out-of-state corporation is present in Kentucky because of its intangible interest in a partnership that is doing business in Kentucky.

A Policy Evaluation of Physical and Metaphysical Presence

You have asked me to evaluate from a policy perspective the merits of physical presence nexus versus metaphysical presence nexus. Various criteria exist for evaluating the relative merits of these competing nexus standards in the context of the values and goals that underlie the commerce clause. The criteria that are evaluated below ask which nexus standard is: (1) more consistent with a bright line test; (2) more consistent with settled expectations; (3) more likely to reduce litigation and foster interstate investment; (4) less likely to discriminate against the service sector; (5) less likely to lead to multiple taxation; and (6) more likely to be fairly or easily administered.

For the reasons explained below, I conclude that physical presence is clearly superior to metaphysical presence as a nexus standard when measured against any of these relevant, principled criteria. Further, I conclude that the

nexus standard for income taxes should be the same as the nexus standard for sales and use taxes.

1. Physical presence is more consistent with a bright line test

The U.S. Supreme Court has emphasized the need for a bright line rule for commerce clause nexus. The reason for a bright line rule is that a nexus standard operates in a stark, all or nothing fashion: a company will be subject to either an income tax or it will not. The need for a bright line test is especially acute where millions of dollars of income taxes can turn on whether nexus exists.

From this policy perspective, an overwhelming virtue of the physical presence standard is that it provides a bright line test. People or tangible property are visible and can be identified through physical observation. Their existence and presence is unambiguous; people or property are either in a state or they are not.

In sharp contrast, metaphysical presence is an amorphous concept, having no crisp edges. The essence of intangible property, such as a partnership interest, a share of stock, or a license agreement, is that it cannot be perceived or physically located. As the dictionary recognizes, intangible property "cannot be easily defined, formulated, or grasped."[1]

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1. Webster's New Universal Unabridged Dictionary (Deluxe 2nd ed.).

Appendix H

Unlike persons or tangible property that can be identified geographically, intangible property cannot be located in any particular state except through legal fictions or doctrines. Various legal fictions include the doctrine of mobilia sequuntur personam, which treats intangibles as attached to the person that owns them. Another legal fiction locates an intangible at the payor's residence, that is, at the residence of the person that pays income to those holding the intangible interest. Yet another approach creates the fiction that an intangible has a business situs.

The problem that arises with these legal fictions is that they do not produce a unique solution to where an intangible is located. For example, the doctrine of mobilia sequuntur personam, when applied to a corporation, can assign intangibles to either the legal domicile of a corporation or its commercial domicile. Further, even the common rule that provides that certain types of intangibles, such as copyrights and patents, are located in the place in which the property is used, does not necessarily locate the intangible unambiguously in only one state. Consider, for example, a manufacturer that enters into a license agreement allowing it to use a secret process to produce and sell widgets. One state might locate the license agreement in the state of manufacturing whereas another might locate it in the state of sale.

Intangible property is not capable of being observed and physically located in one unique state. By contrast, no one can dispute the location of a person or of tangible

property. Compared with a physical presence standard, metaphysical presence not only provides no bright line rule, but also provides no determinate or unique answer to the nexus question. A rule that can locate an intangible simultaneously in more than one state is not a principle of nexus but rather an invitation to chaos.

2. Physical presence is more consistent with settled expectations

There is no U.S. Supreme Court case holding that metaphysical presence satisfies commerce clause nexus. All of the U.S. Supreme Court cases dealing with commerce clause nexus for corporate income tax purposes involved corporations that had a physical presence. None involved an out-of-state corporate partner. Indeed, taxpayers have been very careful in structuring their activities to avoid having a physical presence in those states in which they did not wish to have nexus. In my opinion, the expectation of corporate taxpayers is that no nexus exists under the commerce clause without physical presence.

The metaphysical presence rule is obviously inconsistent with this expectation. If this expectation is to be frustrated by the imposition of a new, metaphysical presence rule, Congress is the only appropriate body to do so. Corporations relying on the physical presence standard have not filed income tax returns on the justifiable assumption that nexus did not exist. Without the filing of a return, the statute of limitations does not run in most states and localities. Consequently,

enormous retroactive exposure exists if a new nexus standard is adopted by a jurisdiction. Congress is the ideal body to balance the interests of the various parties should it decide that the commerce clause nexus standard should be changed.

3. Physical presence will reduce litigation and foster interstate investment

The physical presence nexus standard has the weight of history and tradition behind it. It has been litigated over the years and its boundaries are well known and accepted. It provides a knowable and determinable standard. Long-standing precedent supports the standard, which furthers the stability and orderly development of the law. A long-standing doctrine like that of physical presence offers the kind of stability and predictability that fosters interstate investment.

Metaphysical nexus, by the very nature of intangible property, invites years of litigation. The very fact that intangible property does not physically exist in the way that tangible property or persons exist is an invitation to endless litigation and chaos. Metaphysical presence cannot be expected to have the same crisp, sharp edges as a concept as does physical presence, even after years of litigation. The uncertainty and cloud over the concept of metaphysical nexus can only discourage certain types of interstate investment and thereby thwart the goals of the commerce clause.

4. Metaphysical presence discriminates against the service sector

The physical presence nexus standard has helped maintain tax parity between the service sector and the manufacturing and mercantile sectors of the economy. The manufacturing and mercantile sectors have been the beneficiaries of a special federal nexus statute, Public Law 86-272. The physical presence nexus standard complements Public Law 86-272 in a very significant way that helps maintain a level playing field between the manufacturing and mercantile sectors and the service sector.

Specifically, Public Law 86-272 provides a federal nexus standard by preventing a state from taxing the income of a corporation whose only business activities within the state consist of the solicitation of orders for *tangible personal property*. Public Law 86-272 is limited to tangible personal property and does not extend to services. This limitation is presumably explained by two factors. First, the law was enacted in order to overrule *Northwestern Portland Cement*,[2] which upheld the imposition of a tax on the income of a purely interstate taxpayer selling tangible property--not services.

Second, the law was adopted in 1959, at a time when the service sector was greatly overshadowed by the manufacturing and mercantile sectors. Further, the service sector tended to be intrastate in nature and not

2. 358 U.S. 450 (1959).

interstate. Accordingly, when Public Law 86-272 was adopted, Congress was focusing on the sale of tangible personal property and not on the relatively insignificant interstate service sector.

As interstate services grew in importance and significance, the physical presence rule allowed the service sector to achieve similar protection to that extended to the manufacturing and mercantile sectors under Public Law 86-272. Physical presence nexus is to the service sector what Public Law 86-272 is to the manufacturing and mercantile sectors.

The understanding and expectation of interstate service providers is that as long as they solicit in a state without having people or property in that state, no commerce clause nexus exists and no income tax can be imposed. The requirement of physical presence thus allows the service sector to achieve nearly the same treatment as those taxpayers that are protected by Public Law 86-272. Accordingly, the physical presence standard helps maintain competitive equity between taxpayers that provide services and those competitors that provide tangible personal property.

A metaphysical presence rule would upset this balance and accommodation. Metaphysical nexus would exaggerate, rather than reduce, the competitive inequities of Public Law 86-272. The result would be to move away from a level playing field and discriminate against service providers, thus interfering unfairly and inequitably with the most rapidly growing sector in the U.S. economy.

Appendix H

5. Metaphysical presence will lead to multiple taxation

As discussed above, intangible property has no corporeal form and does not physically exist. Consequently, unlike people or tangible property, intangible property cannot be physically located in any particular state through physical observation. Intangible property can be located in a state only through arbitrary rules that can vary from state to state. Even worse, under the existing doctrines intangible property can be simultaneously present in more than one state, which can easily lead to multiple taxation.

Consider, for example, a state that treats a corporation's partnership interest as being sitused at the corporation's commercial domicile. That state will tax any income received from the partnership. If a state like Kentucky were to tax the same income on the theory that it had its source in Kentucky, double taxation would result. Both states would be imposing a fairly apportioned, internally consistent, nondiscriminatory tax, so that it is not obvious whether either would have the responsibility for eliminating the resulting double taxation.

As another example, consider a corporation that licenses the use of a trademark from L, the licensor. L is incorporated in State I and has its commercial domicile in State C. The corporation agrees to pay a royalty for every good it manufactures and sells bearing L's trademark. Assume the taxpayer manufactures the goods in State M, and sells the goods in State S.

Appendix H

Suppose that state M considers the license to be located in the state of manufacture, that State S considers the license to be located in the state in which the goods are sold, that State C considers the license to be located at the licensor's commercial domicile, and that State I considers the license to be located at the licensor's state of incorporation. Under a metaphysical presence standard, L--the licensor--would have nexus with States M, S, I, and C. The same royalty payment would be taxed by each of these states, resulting in multiple taxation.

As a final example, suppose an out-of-state vendor incorporated in State I, having its commercial domicile in State C, sells machinery to a corporation on an installment obligation. The sale is made in State S but later the customer removes the good to State R. Assume the vendor maintains a security interest in the good, which is filed in State R. The customer is incorporated in State D.

State S considers the installment obligation to be located in the state of sale, State R considers the obligation to be located where the security interest is filed State D considers the obligation to be located at the payor's state of incorporation, State C considers the obligation to be located in the state of the payee's commercial domicile, and State I considers the obligation to be located in the payee's state of incorporation. Under a metaphysical presence standard, the vendor would have nexus with States S, R, I, and D. Income attributable to the installment obligation would

be taxed by each of these states, resulting again in multiple taxation.

6. Metaphysical presence cannot be easily or fairly administered as a nexus standard

Metaphysical nexus presents formidable administrative problems. An author receiving royalties from the sale of a book could be taxable in every state in which the book was sold. A television producer receiving royalties by a network for the use of a program could be taxable in every state in which the program was televised. An electronic data bank receiving payments for the use of its services could be taxable in every state in which its logo appeared on a computer screen. A start up company in Silicon Valley could be subject to tax in every state in which its software licensees operate. A bank purchasing mortgages could be subject to tax in every state in which the underlying mortgagors reside or in which the collateral were located. An athlete receiving royalties from the endorsement of a product could be taxable in every state in which the product was sold. A shareholder receiving dividends from a multistate corporation would be taxable by every state in which the corporation did business.

As these examples suggest, the compliance burdens for taxpayers and administrators would be immense under a metaphysical presence rule. Individuals and small and medium sized businesses would be saddled with the obligation to comply with the tax laws of states with which they would have no familiarity. Administrative

considerations alone suggest that metaphysical presence is incompatible with the values and goals of the commerce clause.

7. The Commerce Clause Nexus Standard Should be the Same for Both Sales and Income Taxes

The U.S. Supreme Court has explicitly held that physical presence is the commerce clause nexus standard for sales and use taxes. Three policy considerations dictate that the same standard should apply for income taxes.

First, the commerce clause is concerned with the problem of multiple taxation. Yet the risk of multiple taxation is greater for income taxes than for sales and use taxes. In the case of the sales and use tax, typically there are only two states that can assert jurisdiction over the transaction: the state of origin and the state of destination. In the case of an income tax, however, a transaction may have contacts with numerous states, as the examples above illustrate. No reason exists to think that the Supreme Court is less concerned about multiple taxation when it occurs in an income tax than when it occurs in a sales tax. The same reasons that led the Court to endorse a physical presence standard for sales and use taxes apply even more strongly in the case of an income tax.

Second, treating income taxes the same as sales and use taxes is not only consistent with the policy values underlying the commerce clause, but also with the

language of the clause. Nothing in the language of the commerce clause refers to specific taxes. There is not one commerce clause for sales and use taxes and another for income taxes. No reason exists, therefore, for a state to develop a different (and lower) nexus standard for income taxes than for sales and use taxes.

Third, the orderly development of the law requires that the same nexus standard should apply to both income taxes and sales and use taxes. If metaphysical presence were to apply to income taxes and physical presence to sales and use taxes, confusion would undoubtedly result because two bodies of doctrine would simultaneously develop side-by-side.

Consequently, policy considerations, the language of the Constitution, and the orderly development of the law require that physical presence be the nexus standard for both income taxes and sales and use taxes.

Conclusion

The Revenue Cabinet is attempting to impose nexus on an out-of-state corporation that does not have any property or payroll in Kentucky. The Revenue Cabinet is treating the out-of-state corporation as having nexus in Kentucky because it has a partnership interest in a partnership that does business in Kentucky. In effect, the Revenue Cabinet is imposing a metaphysical presence standard by attempting to tax a corporation that has an intangible interest in another entity doing business in Kentucky, just like a shareholder has in a

corporation doing business in Kentucky. Its theory is apparently that an interest in a partnership that has nexus in Kentucky creates nexus for those that have an interest in the partnership. In effect, the Cabinet is applying a metaphysical presence nexus standard.

By any principled measure of comparison, physical presence is to be preferred to metaphysical presence as a nexus standard. Physical presence is more consistent with a bright line test, more consistent with settled expectations, more likely to reduce litigation and foster interstate investment, less likely to discriminate against the service sector, less likely to lead to multiple taxation, more easily administered, and more compatible with the growth of electronic commerce.

The Constitution does not distinguish between sales and use taxes and income taxes: there is only one nexus standard and the U.S. Supreme Court has endorsed physical presence.

The country has little experience with administering a metaphysical presence standard; the concept is amorphous and easily malleable. Metaphysical presence is less a legal principle and more an invitation to chaos and multiple taxation, thus undercutting the very goals of the commerce clause that the concept of nexus is intended to further.

APPENDIX I — EXPERT OPINION OF PROFESSOR RICHARD D. POMP, A POLICY ANALYSIS OF THE TAXATION OF OUT-OF-STATE CORPORATE PARTNERS

I. Introduction and Overview

In an earlier report, I discussed the policy considerations that should control the taxation of an out-of-state corporation having no property or payroll in Kentucky, which is a partner in a Kentucky partnership. The Kentucky partnership has nexus with Kentucky by having both payroll and property in Kentucky. The out-of-state corporation is a passive investor in the partnership, much the way a shareholder is a passive investor in a corporation. In general, a partnership and a corporation are both organized under state law pursuant to their own articles of organization and operating agreement. The out-of-of state corporate partner has no control of the partnership's assets, just like a shareholder in a corporation has no control of the corporation's assets. The partner is separate from the partnership for purposes of employer identification numbers, information statements, licenses, payroll taxes, withholding taxes, insurance coverage, trademarks, and qualification to do business, just the way a shareholder is separate from the corporation.

Viewed in this manner, the out-of-state corporate partner should not be considered as having nexus with Kentucky. I set forth numerous policy reasons in my earlier report about why Kentucky should not be seeking to tax persons that do not have a physical presence of their own with Kentucky. A passive investor

in a partnership should not be considered as present in Kentucky merely because the partnership in which it has an interest is doing business in Kentucky.

You have now asked me to state what happens if my preceding views have been rejected and the out-of-state corporation is characterized as having nexus with Kentucky. You have asked me from a policy perspective how the out-of-state corporation should now be taxed.

II. Analysis

If, contrary to the position of the Revenue Cabinet, the out-of-state corporation is not viewed as a passive investor in a partnership receiving income from intangible property, then it should be viewed as participating in the business of the partnership, sharing the capital, property, payroll, receipts, and profit (or loss).

Accordingly, the out-of-state corporate partner should apportion its share of the partnership's income. The factors of the partnership should flow through to the corporate partner in the same ratio that the income of the partnership flows through. Once the view is rejected that the corporate partner is an investor in the partnership, then it should be viewed as an active participant in the business of the partnership and apportion its income accordingly.

Put differently, there are two different paradigms that can apply to out-of-state partners in a Kentucky

partnership. The first is to characterize the partner as an investor, much like a shareholder in a corporation. Under that paradigm, long-standing and well-settled policy considerations dictate that Kentucky should not be able to tax the out-of-state partner if it has no physical presence of its own with Kentucky. Contrary to the position of the Revenue Cabinet, the physical presence of the partnership should not be attributed to the corporate partner.

The Revenue Cabinet is inconsistent in the way it treats investors in Kentucky partnerships and shareholders in Kentucky corporations. The Revenue Cabinet is seeking to tax the former but not the latter. The Revenue Cabinet has never taken the position that the physical presence of a traditional corporation should be attributed to its shareholders.

The Revenue Cabinet is also inconsistent in how it treats one type of partnership—a joint venture—from all other types of partnerships.[1] The receipts, property, and payroll of a joint venture flow through to the partners.[2] In other types of partnerships the Revenue Cabinet

1. Sections 761(a) and 7701(a)(2) of the Int. Rev. Code of 1986 provide that "the term 'partnership' includes a . . . joint venture . . . " "[T]he term 'partner' includes a member in such . . . joint venture . . ." Sec. 7701(2). Kentucky has adopted the federal tax code.

2. Kentucky Revenue Cabinet Tax Policy No. 41P200 (6/1/83).

treats the income as income from intangible property. This different treatment elevates form over substance,[3] which violates one of the most basic of income tax policies.

There is yet a final reason to reject on policy grounds the State's treatment of out-of-state partners. Kentucky apportions the income of an out-of-state partner based on the ratio of gross receipts from sales to purchasers or customers in Kentucky or services performed in Kentucky to the total gross receipts from sales or service everywhere.

From a policy perspective, such a result is clearly inferior to allowing the receipts, property, and payroll of the partnership to flow through to the partners. In the case before the Board, which led to the questions I have been asked to address, the partnership that manufactures and markets tobacco products. Both labor and property contribute significantly to the production of such income. Using only the sales of the partnership to apportion income is to disregard two significant business inputs: capital and labor. From a policy perspective, a formula that better reflects how income is generated by taking into account property and payroll is preferable by and large to one that takes into account only sales and ignores two key business inputs.

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3. Accord, Mark F. Sommer, Kentucky's Distinction Between Multi-State Income from Partnerships and Joint Ventures, 11 J. of State Taxation 26 (1992).

Appendix 1

III. Conclusion

An out-of-state corporate partner that is a passive investor in a partnership should be treated the same as an out-of-state shareholder in a corporation. Such a partner should be viewed as separate from the partnership just the way a shareholder is viewed as separate from a corporation. The activities of a traditional corporation are not attributed to its shareholders; similarly, the activities of the partnership should generally not be attributed to its partners. Consequently, an out-of-state partner that has no property or payroll of its own in Kentucky should not be viewed as having nexus with Kentucky just because the partnership has property or payroll in the State.

If this view is rejected, the partner should be viewed as participating in the business of the partnership, sharing the capital, property, payroll, receipts and profit (or loss). Accordingly, the out-of-state corporate partner should apportion its share of the partnership's income. This approach is consistent with the way the Revenue Cabinet treats one type of partnerships—joint ventures.

In apportioning the income of a partnership that manufactures and markets tobacco products, both labor and capital should be taken into account. Both contribute significantly to the production of income. An apportionment formula should reflect the way in which income is generated.

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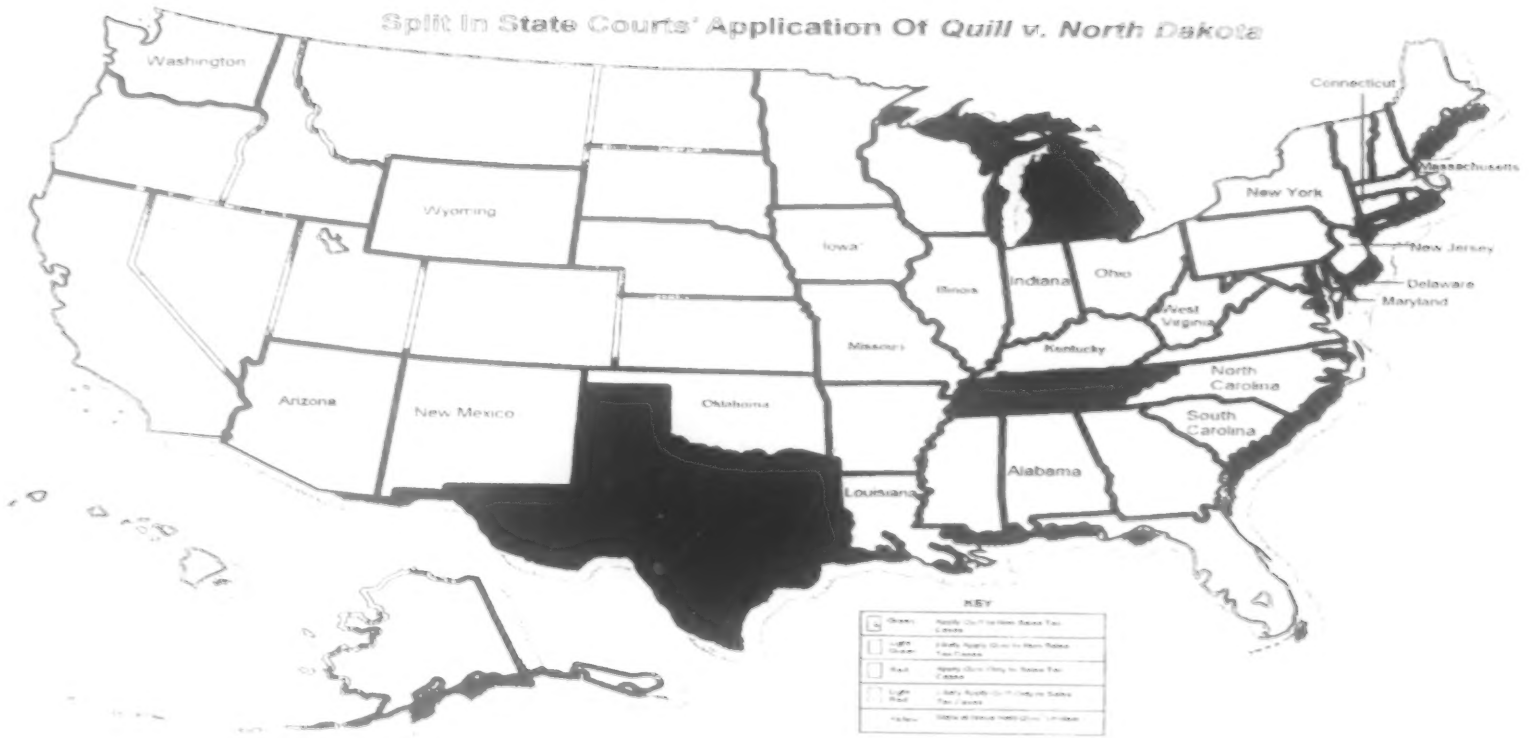

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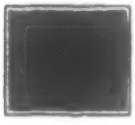
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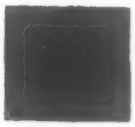
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No. 10-662

Supreme Court, U.S.
FILED
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In The Supreme Court of the United States

ASWORTH, LLC (f/k/a Asworth Corporation); HTF, LLC (f/k/a HT-Forum, Inc.); and D AVIATION SERVICES, LLC (f/k/a D Aviation Services, Inc.),

Petitioners,

v.

DEPARTMENT OF REVENUE, FINANCE AND ADMINISTRATION CABINET, COMMONWEALTH OF KENTUCKY (f/k/a Revenue Cabinet, Commonwealth of Kentucky),

Respondent.

On Petition For A Writ Of Certiorari To The Kentucky Court Of Appeals

BRIEF IN OPPOSITION

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QUESTIONS PRESENTED

1. Whether a State violates the Commerce Clause of the U.S. Constitution by enacting a taxing statute on a partner's share of Kentucky distributive share income from a partnership doing business both within and without Kentucky and deriving income from the partnership's activities in Kentucky when the statute has a doing business nexus standard rather than a physical presence nexus standard?

2. Whether a State violates the Due Process Clause of the U.S. Constitution by passing legislation that changes the calculation of when interest may begin to accrue on a tax refund claim, and such change applies "effective for refunds issued after April 24, 2008"?

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COUNTERSTATEMENT OF THE CASE

A. Physical Presence And *Quill*.

Contrary to Petitioners' assertion, there is no conflict warranting review by this Court, nor is it of pressing significance to American business. As Petitioners themselves admit, 35 states have passed legislation holding that physical presence is not required in order to impose tax outside the context of sales and use taxes. Further, while Petitioners attempt to manufacture a conflict, none exists. Of the three states that Petitioners point to as ruling that *Quill Corp. v. North Dakota*, 504 U.S. 298 (1992) extends to taxes outside of Kentucky, one decision specifically did not rule on this issue and was later called into question by the same court in a later case, the tax in another decision was subsequently eliminated by that State's legislature and replaced by another tax that did not require physical presence, and the third is easily distinguishable based upon the unique facts in that case. Other cases cited by Petitioners never addressed the Commerce Clause, or are merely administrative decisions or advisory opinions, rather than a holding by the State court of last resort. One of the cases relied upon by Petitioners is on appeal and not final. As a result, there is simply no conflict with respect to the Commerce Clause. Similarly, there is no conflict with *Quill* itself, which expressly declined to extend the physical presence standard beyond sales and use taxes.

Finally, the parade of horribles that will purportedly result if the Court does not take this case is simply speculative at best. The statute in dispute was limited to distributive share income from pass-through entities, and in no way extended to all taxpayers or to dividend income. In fact, despite Petitioners' claims to the contrary, American businesses have continued to operate, even in an environment where the majority of states have limited the physical presence standard to sales and use taxes. As the Court noted in *Quill*, resolution of this issue is best left to Congress.

B. Clarification Of House Bills 704 And 216 And Some Historical Context.

Petitioners briefly discuss how 2008 Ky. Acts, ch. 132, §8 ("House Bill 704") and H.B. 216, 2009 Gen. Assem., Reg. Sess. (Ky. 2009) ("House Bill 216," and collectively with House Bill 704, the "Bills"),[1] work mechanically in the Petition, but there are some misstatements that need clarification. Pet. 15, fn. 7. Some historical context is also appropriate in understanding how interest rates have applied to refund claims. When Kentucky first enacted a refund statute, back in 1938, interest was only authorized on overpayments resulting from error of Revenue or its agents. 1938 Ky. Acts, ch. 4, §6. In 1970, this statute

[1] House Bill 216 repealed and reenacted House Bill 704 in response to a potential procedural issue.

was amended to limit the authorization of the accrual of interest to overpayments resulting from a clerical error of Revenue or its agents. 1970 Ky. Acts, ch. 216, §2. In 1976, the law was again changed to increase the applicable interest rate on such refund claims from six percent to eight percent. 1976 Ky. Acts, ch. 155, §1. It was not until 1990 that this statute was amended to expand the authorization of the accrual of interest to refund claims other than constitutional or ad valorem taxes. 1990 Ky. Acts, ch. 423, §7. Notably, interest has never been allowed to accrue on refund claims resulting from constitutional claims or ad valorem taxes. *City of Somerset v. Bell*, 156 S.W.3d 321, 330 (Ky. App. 2005); KRS 134.590. The Constitution simply does not mandate interest on refund payments.

In 1982, KRS 131.183 was enacted to provide that the interest rate on assessments assessed on or after July 1, 1982, shall be 16%, and that the interest rate on certain overpayments would be at a rate equal to 75% of the interest rate on assessments. 1982 Ky. Acts, ch. 452, §3. In 1990, this statute was amended to provide that the interest rate on assessments and overpayments would be the same rate. 1990 Ky. Acts, ch. 423, §5. Notably, the federal government has established different interest rates for underpayments and overpayments since 1987.[2] In

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[2] Tax Reform Act of 1986, Pub. L. No. 99-514, §1511(a), 100 Stat. 2085, 2744 (1986). Originally, the federal government only charged interest on underpayments of tax; only in 1921 was the

(Continued on following page)

1999, the rates were equalized except for corporate taxpayers, who have a difference of one percent and, in some cases, four and one-half percent, between the interest rate for underpayments and overpayments. This is consistent with financial markets and other institutions, where the interest rate paid on savings accounts, for example, is not the same as the interest rate charged on loans. Without such a difference, one of the interest rates is out of synch with the general economy, encouraging either a delay in (i) the payment of taxes, to take advantage of a higher market rate, or (ii) requesting a refund of taxes, to take advantage of the higher interest rate on overpayments.[3] The difference removes such incentive.

Petitioners' claim that such legislation was arbitrary and unfounded is baseless. Notably, as part of this legislation, a fiscal note was attached to House Bill 704, when it was amended to include the disputed provision, which discussed the fiscal impact of the bill and the millions in savings to Kentucky as a result of enacting this legislation. A copy of this fiscal note is reprinted in Respondent's Appendix ("Resp. App.") at 1. As Petitioners note, the Bills also

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law changed to provide for interest on overpayments of federal tax. Internal Revenue Act of 1921, Pub. L. No. 67-98, §1324, 42 Stat. 227, 316.

[3] Similarly, the legislative change with respect to what date interest begins to accrue on an overpayment, encourages the prompt filing of refund claims, and can potentially reduce the amount of interest due at a time when the Commonwealth is experiencing revenue shortfalls and significant budget cuts.

changed the interest rate on refunds from "prime rate" to "prime less 2%," but that provision was prospective only in nature, and therefore not an issue before this Court. Pet. 15, fn. 7.

While Petitioners allege that two Orders granting their refund claims, in whole or in part, were summarily affected by the Bills,[4] pursuant to the Kentucky Court of Appeals' decision, they are not entitled to any refund. Obviously, there can be no interest on a nonexistent refund. Significantly, Petitioners seek a grant of certiorari on whether the denial of the refund claim is unconstitutional. Even assuming *arguendo* that they could prevail on that issue, their refund claim would then be grounded in Ky. Rev. Stat. §134.590. Interest has never been allowed to accrue on refund claims arising pursuant to that statute. *City of Somerset*, 156 S.W.3d at 330. As a result, regardless of whether the Court grants certiorari on the first issue, the interest issue is moot.

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[4] Under Kentucky law, however, a refund is not due until the matter is "finally adjudged" by either the Kentucky Board of Tax Appeals or a Court. Ky. Rev. Stat. §134.580(2). Therefore, Petitioners were not entitled to a refund until there was a final order. The two Orders referred to by Petitioners were not final orders.

C. Clarification Of The Factual Background.

While the material facts were largely stipulated to, there are a few misrepresentations by Petitioners in their Factual Background that need clarification.

Petitioners assert that the parties stipulated that they had no intangible property in Kentucky; however, that is incorrect. A copy of the stipulations is reprinted in its entirety at Resp. App. 4. The parties only stipulated that "[n]one of the [Petitioners] had any property, real or tangible personal, owned or leased, located in Kentucky during the involved tax years." Resp. App. 6. Similarly, the parties stipulated that "[n]one of the [Petitioners] had any employees or payroll in Kentucky during the involved tax years." *Id.* This was because Ky. Rev. Stat. §141.040 applied only to corporations who had either payroll or owned or leased either real property or tangible personal property in Kentucky. Revenue has never asserted that Petitioners were subject to tax pursuant to that statute.

Instead, the issue was (i) whether Ky. Rev. Stat. §141.206 was an imposition statute, and (ii) if so, whether Petitioners were constitutionally subject to tax under that statute. Ky. Rev. Stat. §141.206(5) specifically provides that nonresident corporations, such as Petitioners, "are taxable on their proportionate share of income passed through the partnership . . . attributable to business done in Kentucky" if they are partners in a partnership "which does business

within and without Kentucky[.]" The Kentucky Court of Appeals held that Petitioners' distributive share income (over $50 million during the years in question), which was derived from Petitioners' ownership interests in partnerships that earned income by doing business both within and without Kentucky[5] established either substantial nexus with and/or a physical presence within Kentucky.

Finally, Petitioners also assert that their holdings in partnerships doing business in Kentucky, Conwood Company, LP ("Conwood") and Conwood Sales Co. LP ("Conwood Sales") were passive investments. The parties never stipulated to that fact either. In fact, during at least part of the tax years in question, the parties stipulated that one of the Petitioners, Asworth Corporation (n/k/a Asworth, LLC, "Asworth"), held a general partnership interest in both Conwood and Conwood Sales. Resp. App. 10-11. The parties also stipulated that "[t]he [Petitioners'] business is managing investments in various legal entities." *Id.* at 6.

REASONS FOR DENYING THE PETITION

With respect to the questions presented in the petition, Petitioners have pointed to no genuine

[5] This distributive share income was apportioned to Kentucky pursuant to the apportionment method provided in Ky. Rev. Stat. §141.206(5).

conflict with prior decisions of either this Court or with State courts of last resort. The cases cited in the Petition with respect to the Commerce Clause issue show not conflict, but rather, a growing uniformity among the States which is consistent with the plain language of the Court's decision in *Quill Corp. v. North Dakota*, 504 U.S. 298 (1992). As a result, a decision on the merits would appear to be of little help in resolving other cases.

With respect to the second issue, even if assuming *arguendo* a conflict existed, as an initial matter, resolution of this issue cannot provide relief to Petitioners. If they are not entitled to a refund, the issue of how interest should be calculated on a nonexistent refund is moot. Even if they are entitled to a refund because Ky. Rev. Stat. §141.206 violates the Commerce Clause because it has a doing business standard, rather than a physical presence standard, pursuant to Ky. Rev. Stat. §134.590, no interest accrues on a refund claim based upon a tax being held unconstitutional, so again, the issue of how interest should be calculated on that refund is moot.

Additionally, there is simply no conflict with respect to *United States v. Carlton*, 512 U.S. 26, 30 (1994) or other decisions by the Court, nor are there any conflicts with other States that cannot easily be reconciled as slightly different applications of a properly stated rule of law. For all of these reasons, the Petition should be denied.

I. Rather Than Creating A Conflict Among State Courts, The Decision Enlarges A Growing Consensus Of The States' Highest Courts Rejecting The Claim That The Commerce Clause Requires "Physical Presence" To Establish "Substantial Nexus."

In determining whether to grant certiorari, the Court requires that a conflict of decisions be a "real and embarrassing conflict of opinion and authority." *Rice v. Sioux City Cemetery*, 349 U.S. 70, 79 (1955) (quotations omitted). Here, no such conflict exists. Since *Quill* was decided in 1992, the overwhelming majority of state courts have held that physical presence is not required in order for a State to impose a fairly apportioned, non-discriminatory net income tax on corporations doing business in the taxing State. No State supreme court has held otherwise. While Petitioners do their best to manufacture a conflict, a closer reading of the cases involved show that, if anything, there is a growing consensus, rather than a split, and there is no "real and embarrassing conflict of opinion and authority" warranting the granting of certiorari.

In attempting to establish their claim that a conflict exists, Petitioners rely primarily on *J.C. Penney Nat'l Bank v. Johnson*, 19 S.W.3d 831 (Tenn. Ct. App. 1999), *cert. denied*, 531 U.S. 927 (2000). While on its face, this case appears to represent a wooden application of the *Quill* physical presence test with no meaningful discussion or analysis of the

differences between the taxes in *J.C. Penney* and *Quill,* it actually declined to rule on this issue. *Id.* at 839 ("Any constitutional distinctions between the franchise and excise taxes presented here and the use taxes contemplated in *Bella Hess* and *Quill* are not within the purview of this court to discern.") This conclusion was largely based on the fact that no evidence had been presented as to why the Commerce Clause should be different for franchise and excise taxes. *Id.* The *J.C. Penney* court also held that it was not its role to determine whether physical presence is required under the Commerce Clause. *Id.* at 842. As one court noted, " . . . because the court in *J.C. Penney* specifically declined to address the precise issue before this court [whether *Quill's* physical presence requirement applied to taxes other than sales and use], we find its holding to have little value to our determination of the instant case." *Bridges v. Geoffrey, Inc.*, 984 So.2d 115, (La. App. 2008), *writ denied,* 978 So.2d 370 (2008). Significantly, the continued validity of the *J.C. Penney* opinion has been called into doubt in a subsequent unpublished decision by that court. *See e.g., American Online, Inc. v. Johnson*, 2002 WL 1751434 (Tenn. Ct. App. 2002) (rejecting a reading of *J.C. Penney* that "would simply substitute 'physical presence' for 'nexus.'").[6] Another court, in

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[6] Although unpublished, *America Online* has been relied upon in a published decision of the Tennessee intermediate appellate court. *Arco Building Systems, Inc. v. Chumley*, 209 S.W.3d 63, 74 (Tenn. App. 2006).

analyzing the two cases, concluded there was " . . . considerable doubt on whether [the Tennessee Court] adopted 'a bright-line test of requiring an out-of-state company to have a 'physical presence' in [Tennessee] in order to have substantial nexus with it.'" *A & F Trademark, Inc. v. Tolson*, 605 S.E.2d 187, 196 (N.C. App. 2004), *cert. denied*, 546 U.S. 821 (2005) (citation omitted).

Another case cited by Petitioners, *Rylander v. Bandag Licensing Corp.*, 18 S.W.3d 296 (Tex. App. 2000), likewise does not create a conflict. In *Rylander*, Texas sought to tax an out-of-State corporation merely because it had a license to do business in Texas. *Id.* at 299. The court held that possession of a license to do business, without any other economic activity, did not satisfy the substantial nexus requirement of *Complete Auto Transit*.[7] In addition, as recognized by *Geoffrey, Inc. v. Oklahoma Tax Commission*, 132 P.3d 632 (Okla. App. 2005), *cert. denied*, 510 U.S. 992 (1993), the language from *Allied-Signal* relied upon by the *Rylander* court was taken from the Court's discussion concerning Due Process, not the Commerce Clause, and is preceded by a citation to the Due Process portion of the *Quill* opinion. *Geoffrey*, 132

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[7] Petitioners cited two other Texas decisions: *Midland Cent. Appraisal Dist. v. BP America Prod. Co.*, 282 S.W.3d 215, 224 (Tex. App. 2009) and *Peoples Gas, Light, and Coke Co. v. Harrison Cent. Appraisal Dist.*, 270 S.W.3d 208 (Tex. App. 2008), which do little to establish that a conflict exists. Both involved ad valorem tax on the ownership of oil that was in transit in interstate commerce in a common carrier pipeline.

P.3d at 638. As a result, there is no conflict with respect to the Commerce Clause.[8] Whether there is a conflict with respect to the Due Process Clause is not an issue raised in the Petition.

Similarly, *Guardian Indus. Corp. v. Dep't of Treasury*, 499 N.W.2d 349 (Mich. App. 1993), *app. denied sub nom.*, 512 N.W.2d 846 (Mich. 1994) does not create a conflict. In this case, the taxpayer's principal place of business was in Michigan. The *Guardian* court was faced with the rather unique question of whether "sales" in other States were subject to tax in those States, and therefore excluded from Michigan income. Specifically, the question was whether Guardian had a physical presence in those other States, and if so, whether the activities conducted on Guardian's behalf exceeded that of mere solicitation. If it did not, then Michigan's single business tax would apply to those sales. *Id.* at 358. Here, the taxpayers argued that their nexus in other States was sufficient for taxation by those States; Michigan argued that nexus was insufficient in those States; and the taxing authorities in the other States were not involved in the case. Finally, *Guardian* has little remaining force even in Michigan: the Michigan legislature has eliminated the tax at issue

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[8] Similarly, Petitioners assert that this decision conflicts with *Acme Royalty v. Dir. of Revenue*, 96 S.W.3d 72 (Mo. 2002); however the Commerce Clause was not an issue in that case, either. As a result, there can be no conflict with respect to the Commerce Clause.

in *Guardian* and enacted a new tax that does not require a physical presence. MCL 208.1200(1). As a result, this decision does not present a "real" conflict.

Petitioners cite various opinions on page 22 of their Petition as acknowledging an "ever-growing" split; however, that is simply not the case. In fact, the *MBNA* court merely acknowledged that the Supreme Court had left the question open regarding the applicability of *Quill* to income and franchise taxes, which is not the same as acknowledging an "ever-growing" split between the states. *Tax Com'r of State v. MBNA America Bank, N.A.*, 640 S.E.2d 226, 231 (W.Va. 2006), *cert. denied*, 551 U.S. 1141 (2007). In Massachusetts, the *Geoffrey* decision merely references the following in its analysis:

> Contrast *Rylander v. Bandag Licensing Corp.*, 18 S.W.3d 296, 299, 301 (Tex. Ct. App. 2000) (concluding that franchise tax based solely on taxpayer's mere possession of license to do business in Texas was invalid, but not addressing whether royalty payments from licensing of intangibles were sufficient to satisfy substantial nexus).

Geoffrey, Inc. v. Com'r of Revenue, 899 N.E.2d 87, 93 (Mass. 2009), *cert. denied*, 129 S.Ct. 2853 (U.S. 2009). Similarly, the *Capital One* case cited in the Petition contrasts the *J.C. Penney* decision in a footnote, and also acknowledges that this decision was subsequently questioned by *America Online*. *Capital One Bank v. Com'r of Revenue*, 899 N.E.2d 76, 85, fn. 16 (Mass. 2009), *cert. denied*, 129 S.Ct.

2827 (U.S. 2009).[9] Again, such references do not rise to the level of acknowledging an "ever-growing" split between the states. In fact, if anything, over time, the split has grown less, not more, as New Jersey has reversed itself on this issue,[10] Tennessee has questioned its earlier decision in *J.C. Penney*, and the Michigan legislature has eliminated the tax at issue in *Guardian* and enacted a new tax that does not require a physical presence. Page 18 of the Petition also notes that "[f]urther, at least 35 states have enacted legislation, regulations or policies specifically rejecting the physical presence test in income tax settings and stating that partnership interests alone create tax nexus. . . ." These statutory developments reduce the significance of the issue raised by Petitioners, provide consistency in the treatment of taxpayers, and further negate the need for review by this Court. Rather than a conflict existing between

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[9] In footnote 12 on page 22 of the Petition, while it is true that *Chase Manhattan Bank v. Gavin*, 733 A.2d 782 (Conn. 1999), *cert. denied*, 528 U.S. 965 (1999) noted that *Quill* was not limited to sales and use tax related disputes, that comment was in the context of *Quill's* Due Process analysis, not the Commerce Clause.

[10] Part of the split recognized by the court in *A & F Trademark, Inc. v. Tolson*, 605 S.E.2d 187 (N.C. App. 2004), *cert. denied*, 546 U.S. 821 (2005), was the New Jersey Tax Court's decision in *Lanco* that the physical presence requirement applied; however, that Tax Court decision was ultimately reversed, with the Supreme Court of New Jersey holding in *Lanco, Inc. v. Dir., Div. of Taxation*, 908 A.2d 176 (N.J. 2006), *cert. denied*, 551 U.S. 1131 (2007), that the physical presence requirement did not extend to income tax.

the States on this issue, there is increasing uniformity and consensus.

With respect to Commerce Clause decisions involving pass-through entities, Petitioners attempt to rely on *BIS LP, Inc. v. Dir., Div. of Taxation*, 25 N.J. Tax 88 (N.J. Tax 2009), *appeal docketed,* No. A1172-09 (N.J. Super. Ct. App. Div. Nov. 9, 2009);[11] however, that decision is a Tax Court decision, not a decision of the State's court of last resort, and critically, that decision is not final as it is on appeal to the New Jersey Superior Court. Similarly, several other cases cited in footnote 10 on page 18 of the Petition are administrative decisions and advisory opinions, not decisions of a State court of last resort. Supreme Court Rule 10 is clear that in considering whether to grant certiorari based on an alleged conflict, the conflict must be real and between state courts of last resort.

Petitioners cite another case involving pass-through entities in an attempt to establish a conflict, *Lanzi v. Alabama Dep't of Revenue*, 968 So.2d 18 (Ala. App. 2006), but even the plain language of the Petition shows that no conflict can exist with respect to the Commerce Clause, as the "Commerce Clause argument [was] not reached by the court." Pet. 18, fn. 10. The *Lanzi* court decided the case on Due Process

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[11] Moreover, the issue in *BIS* was whether the corporate partner was unitary with the partnership, not whether *Quill* applied, which is not an issue in this case.

grounds, however, Due Process is not an issue raised in the Petition. More importantly, Alabama has since moved away from the *Lanzi* decision. As held by the same court in a subsequent case, *Prince v. State Dep't of Revenue*, 2010 WL 1837773 (Ala. App. 2010) (not yet released for publication):

> We agree with Prince that the facts in *Lanzi* are not easily distinguishable from the facts in the present case with regard to due-process analysis. However, because *Lanzi* is a plurality opinion, it does not constitute binding authority. *See Waddell v. Waddell*, 904 So.2d 1275, 1285 (Ala. Civ. App. 2004). To the extent that the plurality opinion in *Lanzi* suggests that the imposition of a tax on the income Prince derived from the sale of Zebra.net's assets violates the Due Process Clause, we reject that view as inconsistent with our understanding of the Due Process Clause as requiring only "'some definite link, some minimum connection, between a state and the person, property or transaction it seeks to tax.'" *Allied-Signal*, 504 U.S. at 777.

Id. at *10. Ultimately, the *Prince* court held that a nonresident shareholder in a resident S corporation was subject to income tax based on income received through the sale of the resident corporation's Alabama assets, even though the nonresident shareholder did not engage in the operation or management of the S corporation. *Id.* at *9, 10.

Finally, Appendix J and K of the Petition fail to bear out Petitioners' assertion that a conflict exists.

With respect to the three states where courts have purportedly held that *Quill* applies to non-sales tax cases, none of these decisions were by their State's highest court and all are at least 10 years old. Further, *Rylander* was based on the Due Process Clause, rather than the Commerce Clause, *J.C. Penney* specifically held it was not deciding this issue and it has been subsequently called into question, and *Guardian* is no longer of effect, as the legislature eliminated the tax at issue and enacted a new tax that does not require a physical presence. The Appendix also lists other states as "likely to rule" in a certain way, but conflict warranting certiorari is to be real, not speculative. The Appendix also mysteriously lists New Jersey as "likely to apply *Quill* only to sales tax cases" when the New Jersey Supreme Court has expressly ruled on this issue; there is no "likely to apply" about it. *Lanco, Inc. v. Dir. Div. of Taxation*, 908 A.2d 176, 177 (N.J. 2006), *cert. denied*, 551 U.S. 1131 (2007) ("We believe that the better interpretation of *Quill* is the one adopted by those states that limit the Supreme Court's holding to sales and use taxes."). There simply is no "ever-growing conflict," let alone the "real and embarrassing" conflict necessary to warrant the granting of certiorari. If anything, there is growing consensus, both by recent decisions and State legislatures, on this issue. As a result, the Petition should be denied.

II. The Decision Is Consistent With *Quill*, Which Explicitly Holds That The Court's Precedents Do Not Establish A Physical Presence Requirement Beyond Sales And Use Taxes.

Although Petitioners assert otherwise, no precedent of this Court imposes a "physical presence" requirement for state franchise or income taxes as a precondition for "substantial nexus" under the Commerce Clause. Such a requirement exists only when collection of sales and use taxes is at issue. The test set forth in *Complete Auto Transit v. Brady*, 430 U.S. 274 (1977), does not require a physical presence standard and should not now be altered to impose such a requirement for the income tax at issue here.

The Court in *Quill* re-examined the physical presence requirement set forth in *National Bellas Hess v. Department of Revenue* with respect to sales and use tax. In this examination, the Court noted that formal requirements such as physical presence had, in the interim, more generally been rejected in the Court's Commerce Clause cases, culminating in *Complete Auto. Quill Corp. v. North Dakota*, 504 U.S. 298, 309-11 (1992). The Court concluded however, that there was no sufficient reason to overturn the *Bella Hess* requirement in the sales and use tax area, citing *stare decisis* and Congress's own ability to change the result reached in that decision. *Id.* at 314-18.

Income tax is simply outside the scope of the precedents of this Court in *Bella Hess* and *Quill*. *Quill* itself specifically notes that such a requirement has not been imposed outside the sales and use tax context. Thus, not only is there no language in *Quill* supporting the extension of a physical presence requirement to any tax other than sales and use taxes, but the Court specifically states that in reviewing "other types of taxes [it had not] articulated the same physical-presence requirement." *Quill*, 504 U.S. at 314; *see also id.* at 317 ("in our cases subsequent to *Bellas Hess* and concerning other types of taxes we have not adopted a similar bright-line"). Simply put, there is no need to look beyond the plain language in *Quill* to disprove Petitioners' assertion that the Kentucky decision will "obliterate" the physical presence test set forth in *Quill*. Since *Quill* was decided 18 years ago, the Court has not expanded the physical presence requirement to any tax other than a use tax.

Significantly, the Court in *Quill* not only relied on *stare decisis* tied specifically to the sales and use tax setting, but also acknowledged that, but for *Bellas Hess*, "contemporary Commerce Clause jurisprudence might not dictate the same result were the issue to arise for the first time today," thus confirming that, contrary to Petitioners' assertion, the *Complete Auto* standard does not generally contain such a physical presence requirement. *Quill*, 504 U.S. at 311; *see id.* at 314 (Commerce Clause law generally "now favors more flexible balancing analyses"). Justice Scalia,

whose concurring opinion was joined by Justices Kennedy and Thomas, relied even more heavily on *stare decisis* in *Quill* (*id.* at 320):

> I also agree that the Commerce Clause holding of *Bellas Hess* should not be overruled. Unlike the Court, however, I would not revisit the merits of that holding, but would adhere to it on the basis of *stare decisis*. *American Trucking Assns., Inc. v. Smith,* 496 U.S. 167, 204 (1990) (SCALIA, J., concurring in judgment). Congress has the final say over regulation of interstate commerce and it can change the rule of *Bellas Hess* simply by saying so.

As New York's highest court described the result: "the *Quill* decision cannot be substantively construed as other than a somewhat begrudging retention of the *Bellas Hess* physical presence requirement" for imposition of a sales tax collection obligation. *Orvis Co., Inc. v. Tax Appeals Tribunal*, 654 N.E.2d 954, 960 (N.Y.), *cert. denied sub nom.*, 516 U.S. 989 (1995).

Petitioners incorrectly argue that "substantial nexus" can *only* be established through a physical presence standard. However, this assertion is rebutted by the plain language in *Quill*. Such a result also conflicts with the substantive analysis required by *Complete Auto*, which generally requires that interstate commerce pay its own way. *Complete Auto*, at 288-89, fn. 15. Petitioners also assert that the Kentucky Court of Appeals incorrectly juxtaposed the Commerce Clause and Due Process standards. Again,

this is not the case. The fourth prong of the *Complete Auto* test is that the tax must be "fairly related to services provided by the state." *Id.* at 287 (1977). The decision is fully consistent with *Complete Auto* and does not warrant further review by this Court. Significantly, Petitioners misstate the facts when they claim that they "have absolutely *no* physical presence in Kentucky, as stipulated to by Respondent – no real, tangible or intangible property, no office and no employees located in Kentucky." Pet. 27. What Revenue stipulated to was that (i) Petitioners did not have payroll in Kentucky during the relevant tax years, and (ii) Petitioners did not own or lease either real property or tangible personal property in Kentucky during the relevant tax years. Resp. App. 6. Throughout this case, the Revenue has consistently stated that Petitioners were not subject to corporation income tax pursuant to KRS 141.040 (which required that Petitioners either have payroll in Kentucky, or own or lease either real property or tangible personal property in Kentucky before tax could be imposed under that statute). Revenue has also consistently argued, and the Kentucky Court of Appeals agreed, that Petitioners were subject to tax on their distributive share income from partnerships doing business both within and without Kentucky pursuant to KRS 141.206. The statement that Revenue stipulated that Petitioners had no intangible property in Kentucky is simply untrue.

It is also a stretch to claim that under the Kentucky Court of Appeals' reasoning, *all* companies will

now be subject to state taxation as long as they receive income from an in-state company receiving "protection and benefits" from that state.[12] The statute in question only applied to shareholders or members of limited liability pass-through entities and S corporations with respect to their distributive share income; not shareholders of C corporations or any dividends they might receive. The Kentucky Court of Appeals held that Petitioners had either a substantial nexus with Kentucky or physical presence in Kentucky because of its partnership activities, citing *Borden Chemicals & Plastics, L.P. v. Zehnder*, 726 N.E.2d 73, 79-82 (Ill. App. 2000) (Commerce Clause does not prohibit Illinois from assessing replacement tax on a limited partner which has no connection with Illinois other than investing in a partnership). In discussing *Quill*, the *Borden* court held that "[w]e conclude that the requirement of a physical presence does not apply to the present case and, even if it did, plaintiff has a physical presence in the form of the Operating Partnership." *Borden*, 726 N.E.2d at 80. In fact, Petitioners must now accept that they have no complaint that the Kentucky taxes at issue are anything but fairly apportioned, non-discriminatory, and fairly related to the services ("protections and benefits") it receives from Kentucky, as these issues are

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[12] Again, the parties stipulated that Petitioners were in the business of managing investments in other entities, and that one of the Petitioners held a general partnership interest for part of the tax years in question. Resp. App. 5, 8-9.

not part of the Petition. Issues regarding apportionment, discrimination and fairly related are separate and distinct from nexus.

With respect to the income taxes at issue here, Petitioners cannot legitimately claim any surprise or violation of settled or reasonable expectations in being subjected to taxation that is fairly apportioned, non-discriminatory, and fairly related to the services provided by Kentucky. In fact, Petitioners initially paid the taxes in question and only later filed refund claims. Moreover, the lack of a bright-line physical presence standard in the context of income tax is consistent with unitary cases, where a corporation with no physical presence in a state may be taxed by that state if that corporation is considered to be so closely intertwined with other related entities as to be treated under the legal fiction of being part of a single unitary group. *Barclays Bank PLC v. Franchise Bd. of Calif.*, 512 U.S. 298 (1994). In *Barclays*, the United Kingdom cited *Quill* in support of its argument that Barclays Group members operating exclusively outside the United States did not have sufficient contacts with California under the Commerce Clause. *Id.* at 312. The Court rejected this argument, stating there were "certain intangible 'flows of value' within the unitary group serve to link the various members together as if they were essentially a single entity." *Id.* While the companies themselves did not have an actual physical presence in California, the unitary relationship with companies who did have a

California presence was held to satisfy the Commerce Clause. *Id.*

Petitioners claim that failure to impose a physical presence requirement would create "unconscionable results"; however, this assertion is clearly incorrect for several reasons. First, Petitioners themselves initially paid the tax before later filing refund claims. Second, even the "physical presence" standard is not the bright line test that Professor Pomp asserts it to be. As Justice White pointed out in *Quill*, "reasonable minds surely can, and will, differ over what showing is required to make out a 'physical presence' adequate to justify imposing responsibilities for use tax collection." *Quill*, 504 U.S. at 330, 331 (concurring in part and dissenting in part). Third, interstate commerce has continued to flourish under modern Commerce Clause jurisprudence, even in the absence of an overarching "physical presence" requirement, and more importantly, even though " . . . at least 35 states have enacted legislation, regulations or policies specifically rejecting the physical presence test in income tax settings and stating that partnership interests alone create tax nexus. . . ." Pet. 18. Petitioners have pointed to no litigation or practical problems arising from these statutes, regulations and policies. Mere speculation does not establish clear proof that this case is of such "gravity and importance" as to warrant review by this Court. In fact, the lack of litigation resulting from these statutes and regulations tends to indicate that the legislation is workable and not unduly burdensome,

and certainly undermining any contrary contention by Petitioners. Even if this should change, Congress can readily intervene to protect the national economic interest, as it has done in other occasions. As this Court said in *Quill*, Congress has the power under the Commerce Clause to "evaluate the burdens that taxes impose on interstate commerce." *Quill*, 504 U.S. at 36. Whatever ruling this Court might make on the merits of the issue here, "Congress remains free to disagree with [the Court's] conclusions." *Id.*

Finally, under Petitioners' theory, a business owning and leasing to another company a store in Kentucky, and generating $100,000 of revenue from the lease, would have physical presence in Kentucky and be subject to taxation. However, companies such as Petitioners, receiving tens of millions of dollars of distributive share income from its partnerships which do business within and without Kentucky, would be immune from a fairly apportioned, non-discriminatory income tax on partners. Similarly, a company receiving millions of dollars in revenue from royalty payments from firms licensed to use its intangible property in Kentucky would also be immune.[13] Such a test would only measure how a taxpayer does business, not the substance or significance of the contacts between a taxpayer and the taxing State. This result would clearly conflict with

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[13] This point also is raised by Justice White in a separate opinion, concurring in part, and dissenting in part, from the majority. *Quill*, 504 U.S. at 327-29.

Complete Auto and its substantive analysis standard. The Petition should be denied.

III. The Decision Neither Eviscerates *Carlton* Nor Furthers A Split On The Constitutional Standards Governing Retroactive Tax Legislation.

A. This Issue Is Moot, As Petitioners Are Not, And Cannot Be, Entitled To Any Interest.

As an initial matter, unless this Court takes the physical presence issue up on certiorari, Petitioners are presently not entitled to any refund of tax, much less interest, and therefore, the issue regarding the retroactive calculation of statutory interest on a nonexistent refund is moot. Even if this Court takes the physical presence issue up on certiorari, and reverses the decision by holding that KRS 141.206 unconstitutionally had a doing business standard, rather than a physical presence standard, the applicable refund statute would be KRS 134.590, which applies to refunds of taxes held unconstitutional. Pursuant to that statute, Petitioners would not be entitled to *any* interest on their refund claim, and so again, this issue is moot. Even assuming *arguendo* that a conflict existed with respect to *Carlton*, resolution of this issue could not change the result below, since Petitioners still would not be entitled to interest. *Sommerville v. United States*, 376 U.S. 909 (1964) (certiorari denied where resolution of the conflict

could not change the result reached below). As the Court has previously stated:

> While this Court decides questions of public importance, it decides them in the context of meaningful litigation. Its function in resolving conflicts among the Court of Appeals is judicial, not simply administrative or managerial. Resolution here of the [issue in conflict among the circuits] can await a day when the issue is posed less abstractly.

The Monrosa v. Carbon Black Export, Inc., 359 U.S. 180, 184 (1959). The Petition should be denied.

B. The Court Has Previously Held That The Retroactive Denial Of Interest Does Not Violate Due Process Or Any Other Constitutional Provision.

The Court has held that the retroactive denial of interest does not violate Due Process or any other constitutional provision. *Morley v. Lake Shore & M.S. Ry. Co.*, 146 U.S. 162, 170, 171 (1892) (law reducing rate of interest upon judgments upheld even when retroactively applied to a judgment obtained prior to the law's enactment, because interest is in the nature of damages, and does not arise out of contract); *Missouri & Arkansas Lumber & Mining Co. v. Greenwood Dist. of Sebastian County*, 249 U.S. 170 (1919). Both of these decisions are still good law, and were not overruled by *Carlton*.

Kentucky has held " . . . that the rate of interest on judgments is a statutory rather than a contractual matter." *Ridge v. Ridge*, 572 S.W.2d 859, 861 (Ky. 1978). Moreover, "As a general rule, unless interest is expressly authorized by statute, it is not awardable against the sovereign." *Department of Revenue v. Jack Cole Co.*, 474 S.W.2d 70, 74 (Ky. 1971), citing *Coleman v. Reamer's Ex'r*, 237 Ky. 603, 36 S.W.2d 22 (1931) (denying interest as the statute authorized interest only when the refund was a result of a clerical error). *See also*, *City of Somerset*, 156 S.W.3d at 330. The Bills, which address how interest is to be calculated on a refund claim, do not violate either Due Process or prior holdings of the Court.

C. The Court Has Previously Upheld Retroactive Statutes That Make A Reasonable Change In The Remedy, And Did Not Require A "Modesty Requirement" As Part Of The Analysis.

The Court has previously noted that the constitutional impediments to retroactive legislation are now "modest." *Landgraf v. USI Film Products*, 511 U.S. 244, 272 (1994). Similarly, in *Bradley v. School Bd. Of Richmond*, 416 U.S. 696 (1974), while a case was pending before the Court of Appeals, Congress enacted a law which authorized federal courts to award a reasonable attorney's fee to prevailing parties in school desegregation cases. The Court held that the award of fees for services performed prior to the effective date of enactment was permissible, as "the

principle that a court is to apply the law in effect at the time it renders its decision, unless doing so would result in a manifest injustice or there is statutory direction or legislative history to the contrary." *Bradley*, 416 U.S., at 711. As the *Landgraf* court noted in discussing *Bradley*, attorney's fees are "collateral to the main cause of action" and "uniquely separable from the cause of action to be proved at trial." *Landgraf*, 511 U.S., at 278, quoting *White v. New Hampshire Dept. of Employment Security*, 455 U.S. 445, 451-52 (1982). The Court has also held that the *Ex Post Facto Clause*, does not limit "legislative control of remedies and modes of procedure which do not affect matters of substance." *Beazell v. Ohio*, 269 U.S. 167, 171 (1925). None of these cases imposed a "modesty" requirement as part of their analysis. Similarly, the issue of how much interest accrues on a refund claim is a remedial measure which is collateral to the main cause of action, namely, Petitioners' right to a refund.

Petitioners have no vested right in a refund claim, much less the interest accruing on a refund claim, nor is interest on a refund claim a contractual obligation. No new rights, duties or obligations are created by the Bills. The Bills neither deprived Petitioners of their right to a refund, assuming they ultimately prevailed on those claims, nor did it completely deprive them of interest. Instead, the Bills merely changed how interest was to be calculated on a refund claim pursuant to Ky. Rev. Stat. §134.580 from interest beginning to accrue after the later of

two (2) different events, to the later of five (5) different events, a procedural measure that did not affect any substantive rights. As a result, the Bills do not violate the Due Process Clause or prior holdings of the Court.

D. The Court Has Previously Upheld An Unlimited Period Of Retroactivity, Which Holdings Were Not Reversed By *Carlton*.

The Bills in question are remedial, rather than tax or economic legislation. However, even with respect to tax and economic statutes, the Court has previously upheld unlimited periods of retroactivity, concluding that in each case, the Due Process Clause was not violated. *Usery v. Turner Elkhorn Mining Co.*, 428 U.S. 1 (1976); *Millikin v. United States*, 283 U.S. 15 (1931). Notably, the Court in *Carlton* quoted both decisions in its discussion of the standard to be applied under the Due Process Clause applied to tax statutes or other retroactive economic legislation:

> Provided that the retroactive application of a statute is supported by a legitimate legislative purpose furthered by rational means, judgments about the wisdom of such legislation remain within the exclusive province of the legislative and executive branches. . . .
>
> To be sure, . . . retroactive legislation does have to meet a burden not faced by legislation that has only future effects. . . . 'The retroactive aspects of legislation, as well as the

> prospective aspects, must meet the test of due process, and the justifications for the latter may not suffice for the former' . . . But that burden is met simply by showing that the retroactive application of the legislation is itself justified by a rational legislative purpose." *Pension Benefit Guaranty Corporation v. R.A. Gray & Co.*, 467 U.S. 717, 729-730 (1984), quoting *Usery v. Turner Elkhorn Mining Co.*, 428 U.S. 1, 16-17 (1976).

Carlton, 512 U.S., at 30-31. In rejecting the taxpayer's claim regarding lack of notice, the Court held that " . . . in *Millikin v. United States*, the Court rejected a similar notice argument, declaring that a taxpayer 'should be regarded as taking his chances of any increase in the tax burden which might result from carrying out the established policy of taxation.' 283 U.S., at 23[.]" *Carlton*, 512 U.S., at 34.

Even if the amount of the tax, rather than the amount of interest accruing on a tax refund, had been involved, the Court in *Carlton* held that avoiding a "significant" loss of public revenues is a constitutionally legitimate purpose. *Id.* at 32. The fiscal note for House Bill 704 specifically noted the millions in savings to Kentucky that would result from changing how the interest on a refund claim is calculated. Resp. App. 1. *Carlton* also held, "[t]ax legislation is not a promise and a taxpayer has no vested right in the Internal Revenue Code." *Id.* at 33. Therefore, there are no substantive Due Process rights involved in this case.

Notably, *Carlton* did not reverse the holdings in either *Usery* or *Millikin*, even though both cases were quoted in its decision.[14] The decision is consistent with the holdings in *Usery* and *Millikin*, as the Bills were supported by a legitimate legislative purpose furthered by rational means.

E. *Carlton* Did Not Mandate A "Modesty Requirement" As A Prerequisite To Any Due Process Analysis.

Despite Petitioners' claims to the contrary, *Carlton* never imposed a "modesty" requirement as a prerequisite to any Due Process analysis. Instead, the Court in *Carlton* held that, "[b]ecause we conclude that retroactive application of the 1987 Amendment to Section 2057 is rationally related to a legitimate legislative purpose, we conclude that the amendment as applied to Carlton's 1986 transactions is consistent with the Due Process Clause." *Id.* at 35. The "modesty" requirement is not contained in the ultimate holding, but instead, is discussed as a factor, but not the controlling factor, to be considered in determining whether the retroactive application is rationally related to a legitimate legislative purpose.

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[14] Notably, *Carlton* did specifically discuss several other cases, and held that "[t]o the extent their authority survives, they do not control here." *Carlton*, 512 U.S., at 34. Clearly, if *Carlton* intended to reverse or otherwise limit *Millikin* and *Usery*, it could have done so.

While it is true that Justice O'Connor, in a concurring opinion, implied that "modesty" was a due process guarantee, her separate opinion carried no other votes.

Justices Scalia and Thomas, in a separate concurring opinion, took the view that the timing of the legislation is not even relevant to the analysis, stating:

> . . . the critical event is the taxpayer's reliance on the incentive and the key timing issue is whether the change occurs after the reliance; that it occurs immediately after rather than long after renders it no less harsh.
>
> The reasoning the Court applies to uphold the statute in this case guarantees that *all* retroactive tax laws will henceforth be valid. To pass constitutional muster the retroactive aspects of the statute need only be "rationally related to a legitimate legislative purpose." *Ante*, at 2024. Revenue raising is certainly a legitimate legislative purpose, *see* U.S. Const., Art. I, §8, cl. 1, and any law that retroactively adds a tax, removes a deduction or increases a rate rationally furthers that goal. I welcome this recognition that the Due Process Clause does not prevent retroactive taxes, since I believe that the Due Process Clause guarantees *no* substantive rights, but only (as it says) process, *see TXO Production Corp. v. Alliance Resources Corp.*, 509 U.S. 443, 470-471, 113 S.Ct. 2711, 2726-2727, 125 L.Ed.2d 366 (1993) (SCALIA, J., concurring in judgment).

Carlton, 512 U.S., at 40 (Scalia & Thomas, JJ., concurring). Contrary to Petitioners' allegations, Justices Scalia and Thomas did not view this result to be a problem, but rather, a welcome result.

Further, Petitioners misrepresent the holding by the Kentucky Court of Appeals with respect to the "modesty requirement." The full text of the decision is as follows:

> The Corporations also contend that the four-year period of retroactivity in this case fails to meet the "modesty requirement" of retroactive tax legislation under *Carlton*. However, contrary to the Corporations' assertion, the holding in *Carlton* did not establish such a "modesty requirement;" rather, the majority simply noted with favor that "Congress acted properly and established only a modest period of retroactivity." *Id.* at 32, 114 S.Ct. at 2023. This suggests to us that the period of retroactivity is to be considered in determining whether the legislation rationally furthers a legitimate governmental purpose. Here the Bills retroactively applied to all outstanding refund claims for taxable years ending prior to the Bills' effective dates, and to all claims for those taxable years pending in any judicial or administrative forum. We hold that the retroactive period extending to outstanding claims as of the Bills' effective dates does not violate the due process clause.

Pet. App. 20a. Rather than ignoring the "modesty requirement," the Kentucky Court of Appeals applied

it in a manner consistent with *Carlton*, both as expressed by the majority and the concurring opinion by Justices Thomas and Scalia, which is that the test is whether the legislation rationally furthers a legitimate governmental purpose, and as part of that test, the period of retroactivity may be considered. The decision is consistent with *Carlton*.

F. There Is No Split Regarding *Carlton*, As The Decisions Can Be Easily Reconciled As Slightly Different Applications Based Upon The Individual Facts And Circumstances Of The Decisions.

Petitioners cite a variety of cases in an attempt to manufacture a conflict; however, the Petition fails to make any showing that the *Carlton* test has bemused the lower courts, or has led to decisions by different courts that cannot easily be reconciled as slightly different applications of a properly stated rule of law. This is not surprising, since the underlying test is whether the retroactive legislation is "rationally related to a legitimate legislative purpose," which by its very nature is highly dependent upon the individual facts and circumstances of a particular case, and is not a one size fits all analysis. Significantly, none of the cases cited by Petitioners involve facts similar to those in this case, namely the calculation of interest on a refund claim.

Petitioners also argue that a shorter "modesty" period should apply to "non-curative" legislation;

however, other than a blanket assertion that the Bills are "non-curative," Petitioners provide no support for this statement, and simply ignore the fiscal note associated with the Bills. Petitioners also cite the *Landgray* [sic] case; however, as previously discussed, *Landgraf* supports the conclusion of the Kentucky Court of Appeals that the Bills did not violate the Due Process Clause.

Finally, Petitioners' argument that a use-it-or-lose-it limitation exists on a legislature's constitutional power cannot be squared with *Carlton's* express holding that "a taxpayer has no vested right in the Internal Revenue Code" protected by the Due Process Clause, 512 U.S. at 33, or reconciled with the precedents upon which *Carlton* relied. *See, e.g., Millikin v. United States*, 283 U.S. 15 (1931) (sustaining statute increasing federal estate tax on gifts made in contemplation of death, applicable with an unlimited period of retroactivity to all gifts made prior to enactment); *Usery v. Turner Elkhorn Mining Co.*, 428 U.S. 1 (1976) (sustaining federal statute imposing liability on employers for black lung benefits, applicable with an unlimited period of retroactivity for all prior employees). Nor can it be squared with the unlimited retroactive effect of the Court's decisions.[15]

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[15] All the Court's decisions are "the controlling interpretation of federal law and must be given full retroactive effect in all cases still open on direct review and as to all events, regardless of whether such events predate or postdate our announcement of the rule." *Harper v. Virginia Dep't of Taxation*, 509 U.S. 86, 97 (1993).

If the retroactive legislation serves a legitimate legislative purpose, it should not be invalidated simply because Congress, or a state legislature, did not act within a year. For all of these reasons, the Petition should be denied.

CONCLUSION

For the reasons stated above, the petition for a writ of certiorari should be denied.

Respectfully submitted,

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APPENDIX A

COMMONWEALTH OF KENTUCKY
STATE FISCAL NOTE STATEMENT

GENERAL ASSEMBLY
2008 REGULAR SESSION

LEGISLATIVE RESEARCH COMMISSION
2008-2010 INTERIM

MEASURE

(X) 2008 BR No. 1721

(X) House **Bill No.** 568 HCS

( ) Resolution No. _____

( ) Amendment No. _____

SUBJECT/TITLE AN ACT relating to interest.

SPONSOR Rep. D. Pasley and H. Moberly Jr.

NOTE SUMMARY

Fiscal Analysis:

X Impact ___ No Impact ___ Indeterminable Impact

Level(s) of Impact

X State ___ Local ___ Federal

Budget Unit(s) Impact _____

Fund(s) Impact:

X General X Road ___ Federal

_____ Restricted Agency (Type)

_____ (Other)

FISCAL SUMMARY

Fiscal Estimates	2007-2008	2008-2009	2009-2010	Future Annual Rate of Change
Revenues (+/-)		+$2,000,000	+$2,000,000	
Expenditures (+/-)				
Net Effect		+$2,000,000	+$2,000,000	

MEASURE'S PURPOSE:

The bill prevents the accrual of interest on refund claims from beginning prior to the Department of Revenue receiving the refund claim.

PROVISION/MECHANICS:

The bill modifies the date from which interest begins to accrue on refunds issued by the Department of Revenue to the latest of:

- The due date of the return;
- The date the return was filed;
- The date the tax was paid;
- The last day prescribed by law for filing the return; or
- The date an amended return claiming a refund is filed.

FISCAL EXPLANATION:

The $2 million fiscal impact noted above represents the ongoing, operational savings to be realized by the Commonwealth.

The provisions of the bill apply retroactively to all outstanding refund claims for taxable years ending prior to the effective date of the Act and also apply to all claims for those taxable years pending in any judicial or administrative forum.

To the extent that the Commonwealth fails to prevail on issues pending litigation, additional savings will be realized to the extent that the date that interest begins to accrue has been set to a later date, in most circumstances, by this legislation.

DATA SOURCE(S) **OSBD**

NOTE NO. **115.1** **PREPARER** **Jennifer Hays**

REVIEW **LBH** **DATE** **2/26/08**

LRC 2008-1721-HB568-HCS

APPENDIX B

COMMONWEALTH OF KENTUCKY
KENTUCKY BOARD OF TAX APPEALS
FILE NOS. K00-R-31, K02-R-30, K02-R-31, K02-R-32

ASWORTH CORPORATION, HT-FORUM, INC. (N/K/A HTF, LLC) AND D AVIATION SERVICES, INC. (N/K/A D AVIATION SERVICES, LLC) — APPELLANTS

v.

STIPULATIONS

REVENUE CABINET (N/K/A FINANCE AND ADMINISTRATION CABINET, DEPARTMENT OF REVENUE), COMMONWEALTH OF KENTUCKY — APPELLEE

* * * * * * *

Come now the Appellants, Asworth Corporation, HT-Forum, Inc., now known as HTF, LLC, and D Aviation Services, Inc., now known as D Aviation Services, LLC (collectively hereinafter referred to as the "Appellants" or individually as ["Asworth"], ["HTF"], and ["D Aviation"], respectively), and the Appellee, Revenue Cabinet now known as Finance and Administration Cabinet, Department of Revenue, Commonwealth of Kentucky ("Revenue"), and hereby submit their Stipulations in this matter.

In accordance with KRS 13B.080 and 802 KAR 1:010, Section 3(5), and pursuant to the Board's Notice and Order of Pre-hearing Conference of March

25, 2005, the Appellants and Revenue agree to these Stipulations pursuant to the general terms of this Preamble.

(A) Any Stipulated Joint Appendix filed with the Board herein identifies all stipulated documents. Except as noted herein, each document is admissible in evidence for any relevant and material purpose.

(B) The truth and/or probative value of assertions contained in any document with any Stipulated Joint Appendix filed with the Board herein are not stipulated and may be corroborated or rebutted by either party unless specifically provided to the contrary. Each stipulated document in any Stipulated Joint Appendix, however, shall be considered true, genuine and authentic and a copy of any stipulated exhibit or document shall be treated as though it were the original of same under the Kentucky Rules of Evidence and KRS Chapter 13B.

1. Asworth is a Nevada corporation created under the laws of Nevada. Asworth maintains its principal place of business in Chicago, Illinois, and it has no commercial domicile in Kentucky. Asworth was formerly known as Dalfort Corporation, but changed its name to Asworth Corporation in or around 1995.

2. HTF was a corporation created under the laws of the State of Delaware, and its principal place of business is also in Chicago, Illinois. It converted to a limited liability company and changed its name to HTF, LLC, effective January 1, 2000.

3. D Aviation was a corporation created under the laws of the State of Delaware, originally under the name of Dalfort Aviation Services, Inc., and its principal place of business is also in Chicago, Illinois, This corporation changed its name to D Aviation on or about December 30, 1997. It later converted to a limited liability company and changed its name to D Aviation Services, LLC on January 1, 2000.

4. Revenue is an administrative agency of the Commonwealth of Kentucky authorized under Chapters 141 of the Kentucky Revised Statutes to enforce the provisions of the Kentucky corporation income tax laws.

5. The Appellants' business is managing investments in various legal entities.

6. None of the Appellants had any property, real or tangible personal, owned or leased, located in Kentucky during the involved tax years.

7. None of the Appellants had any employees or payroll in Kentucky during the involved tax years.

8. None of the Appellants are domiciled in Kentucky, nor have they ever been.

Tax Years 1993-1996

9. As of January 31, 1993, Asworth owned a 99% limited partnership in Conwood Company, LP ("Conwood"), a Delaware limited partnership. Conwood has its commercial domicile and principal

place of business in Memphis, Tennessee. Conwood began its business operations in the 1700's, and is a manufacturer of smokeless tobacco.

10. GP Corporation ("GP"), a corporation incorporated under the laws of the state of Delaware, owned a 1% general partnership interest in Conwood until 1996.

11. For the taxable periods ending January 31, 1993, January 31, 1994, January 31, 1995 and January 31, 1996, Asworth filed Kentucky corporation income tax returns [Forms 720] and paid Kentucky corporate income tax calculated by using the standard three-factor apportionment formula (property, payroll and receipts) under KRS 141.120 to apportion its multistate income to Kentucky, and included the property, payroll and receipts of both Asworth and Conwood.

12. Asworth also filed Kentucky corporation license tax returns and paid the Kentucky corporate license tax of KRS 136.070 using the same methodology it utilized for corporate income tax for the taxable periods ending January 31, 1993 through January 31, 1996.

13. Revenue conducted a corporation income and license tax examination ("audit") of Asworth for taxable years ending January 31, 1993 through January 31, 1996. At the end thereof, Revenue asserted that Asworth had an increased corporation income tax of $654,629, plus applicable interest and penalties, and a decreased corporate license tax

liability of $79,229 for taxable years ending January 31, 1993 through January 31, 1996.

14. During this audit, Revenue examined Asworth's ownership in the partnership(s) involved herein. In concluding that Asworth's partial ownership of Conwood constituted Asworth's only connection to Kentucky, Revenue also concluded that Asworth should not have included the receipts of Asworth and all of its affiliated entities' receipts in the calculation. Consequently, Revenue redetermined Asworth's receipts apportionment factor, and included only Conwood receipts in Kentucky [presented in the formula] over Conwood receipts everywhere in the calculation(s).

15. Revenue also determined that Asworth was not required to file a Kentucky corporation license tax return, as was stated in the Auditor's Narrative Report, "[b]ecause the taxpayer's only tie to the state of Kentucky is investments in partnerships. . . ." Agent's Narrative Report.

16. Based on this single-factor apportionment methodology, Revenue concluded that a corporation income tax deficiency existed, but also determined that Asworth had no corporation license tax liability because Asworth had no property or payroll in Kentucky. Revenue has since refunded the corporate license tax overpayment to Asworth.

17. Asworth chose not to protest the assessment, and after payment of the assessed taxes, it then filed amended returns requesting a refund of

$1,993,207, which amount represents the corporation income taxes paid with the original returns, as well as the increased amount of tax due to Revenue's audit assessment. Interest, penalties and fees in the amount of $410,804 were paid in addition to the tax amount set forth above. Thus, Asworth's refund claim for tax periods ending January 31, 1993 through January 31, 1996 totaled $2,404,011 including tax, interest, fees and penalties.

18. Asworth paid the audit-related assessed tax and interest on November 5, 1998, and paid the assessed penalties and fees on February 5, 1999. On November 11, 1998, Asworth filed a refund claim for the taxable year ending 1994 and, on January 15, 1999, filed a refund claim for the remainder of the taxable years under audit, contending that it had no nexus with Kentucky under KRS Chapter 141, and therefore was not subject to corporate income tax.

19. The parties are in agreement that Asworth's refund claims for tax years ending January 31, 1994 through January 31, 1996 were timely filed.

20. The parties are also in agreement that Asworth's refund claim for taxable year ending January 31, 1993 insofar as it pertains to the tax, interest, penalties, and fees paid on November 5, 1998, was timely.

21. Asworth requested a conference with Revenue pursuant to KRS 131.110 and the conference was held on April 27, 2000. Revenue denied all of Asworth's claims for refund on May 3, 2000, and

Asworth filed a timely Protest in response to Revenue's denial of the refund claim on June 15, 2000. Asworth filed a Supporting Statement on July 31, 2000.

22. On November 17, 2000, a second conference with Revenue was held. A Final Ruling was requested on that date pursuant to KRS 131.110. Asworth filed a second Supplemental Supporting Statement addressing certain constitutional issues on November 29, 2000.

23. Revenue subsequently issued a Final Ruling on November 29, 2000 upholding its denial of Asworth's corporation income tax refund claims.

24. Asworth filed a timely Petition of Appeal with the Kentucky Board of Tax Appeals on December 28, 2000.

25. Asworth exhausted all required administrative steps prior to filing this action.

Tax Years 1997-1999

26. Asworth's corporate structure changed in that from November 1, 1996 through April 30, 1997: (1) Asworth contributed 1% of its limited partnership interest in Conwood to D Aviation Services; (2) GP merged with Asworth and thus acquired GP's 1% interest; and (3) Asworth converted 51% of its limited partnership interest in Conwood into a general partnership interest. As a result of Asworth's above changes in corporate structure, Asworth's total

general partnership interest equaled 52% and Asworth's limited partnership interest equaled 47%.

27. Asworth thereafter contributed its 47% limited partnership interest in Conwood to HTF, and Conwood Sales Company LP ("Conwood Sales"), a Delaware limited partnership, with its commercial domicile and principal place of business in Memphis, Tennessee, was formed to conduct sales and marketing activities; in return for this contribution each partner of Conwood received an identical ownership interest in Conwood Sales.

28. Conwood and Conwood Sales are distinct legal entities and are independent from the Appellants.

29. On November 15, 1996, Asworth contributed 1% of its limited partnership interest in Conwood to D Aviation. Asworth contributed its limited partnership interests in Conwood and Conwood Sales to D Aviation on April 30, 1997, and D Aviation changed its tax year end to December 31, effective with the tax year ended December 31, 1997.

30. From May 1, 1997 through December 31, 1999 the corporate structure changed as follows: (1) Conwood LLC, Conwood-1 LLC and Conwood-2 LLC, all single member LLCs, were formed in 1997; (2) Asworth contributed a 5% general partnership interest in Conwood and a 5% general partnership interest in Conwood Sales to Conwood LLC; (3) Asworth converted the remaining 47% general partnership interest in Conwood to a limited partnership

interest and then contributed that to HTF; (4) Asworth converted the remaining 47% general partnership interest in Conwood Sales to a limited partnership interest and then contributed it to HTF; and (5) Asworth and HTF changed their tax year ends to December 31, effective with the tax year ended December 31, 1997.

31. For the years ending January 31, 1997, December 31, 1997, December 31, 1998 and December 31, 1999, Asworth filed Kentucky corporation income tax returns and paid Kentucky corporation income tax.

32. For the years ending January 31, 1997, December 31, 1997, December 31, 1998 and December 31, 1999, HTF filed Kentucky corporation income tax returns and paid Kentucky corporation income tax.

33. For the years ending January 31, 1997, December 31, 1997, December 31, 1998 and December 31, 1999, D Aviation filed Kentucky corporation income tax returns and paid Kentucky corporation income tax.

34. On or about January 30, 2001, Asworth believes it timely filed amended returns/refund claims with Revenue, contending that it did not have any tax liability in Kentucky and sought tax refunds and statutory interest for all such tax paid for the taxable years ending January 31, 1997 and December 31, 1997 ("1997 Refund Claims").

35. Revenue has agreed that Asworth's counsel's letter of March 26, 2001 constituted a timely refund claim for the 1997 Refund Claims.

36. The 1997 Refund Claims have not been approved or denied to date by Revenue, and are not before this Board for review.

37. On August 16, 2002, Asworth timely re-filed an amended return/refund claim with Revenue, contending that it did not have any tax liability to Kentucky, and seeking refunds and statutory interest for all such tax paid for the taxable year ending December 31, 1997.

38. The parties agree that the 1997 Refund Claims will be held in abeyance at the Department pending a final and unappealable decision by the Board or any Court. The parties further agree to be found by a final and unappealable Board or Court decision, such that if the Appellants prevail on the nexus issue, refunds will be paid to Asworth, plus statutory interest through the date of the final and unappealable decision, and such that if the Appellee prevails on the nexus issue, the 1997 Refunds will be denied.

39. The parties further agree that the apportionment methodology approved by the Board or a Court in a final and unappealable decision in the matter herein will be applied to the 1997 Refund Claims (e.g., if single-factor apportionment is upheld, it will also apply to the 1997 Refund Claims, and if

three-factor apportionment is upheld, it will apply to the 1997 Refund Claims).

40. On January 16, 2001, Asworth timely filed amended returns refund claims with Revenue, contending that it did not have any tax liability in Kentucky, and sought refunds and statutory interest for all such tax paid for the taxable years ending December 31, 1998 and December 31, 1999 (the "1998-1999 Refund Claims").

41. On January 16, 2001, HTF timely filed amended returns/refund claims with Revenue, contending that it did not have any tax liability to Kentucky, and seeking refunds and statutory interest for all such tax paid for the taxable years ending January 31, 1997, December 31, 1997, December 31, 1998 and December 31, 1999 (the "HTF Refund Claims").

42. On January 16, 2001, D Aviation timely filed amended returns/refund claims with Revenue, contending that it did not have any tax liability to Kentucky, and seeking refunds and statutory interest for all such tax paid for the taxable years ending January 31, 1997, December 31, 1997, December 31, 1998 and December 31, 1999 (the "D Aviation Refund Claims").

43. Revenue subsequently denied the 1998-1999 Refund Claims, the HTF Refund Claims and the D Aviation Refund Claims, which led to a Protest, and then to this proceeding.

44. Revenue's refund denial letter of April 29, 2002 denied the 1998-1999 Refund Claims of $78,753, plus applicable statutory interest. The refund denial letter also denied the HTF Refund Claims in the aggregate amount of $1,952,820, plus applicable statutory interest. The refund denial letter further denied D Aviation's Refund Claims in the aggregate amount of $16,887, plus applicable statutory interest.

45. The Appellants timely protested the denials of the 1998-1999 Refund Claims, the HTF Refund Claims and the D Aviation Refund Claims.

46. After various administrative proceedings, Revenue issued final ruling letters on July 24, 2002 regarding the 1998-1999 Refund Claims, the HTF Refund Claims and the D Aviation Refund Claims.

47. The Appellants filed timely Petitions of Appeal with the Kentucky Board of Tax Appeals on August 15, 2002 in response to the July 24, 2002 Final Ruling letters.

48. On August 22, 2002, the Appellants filed a Motion to Consolidate all four appeals (KBTA File Nos. K00-R-31, K02-R-30, K02-R-31, K02-R-32), and on June 4, 2003, the Board granted the Motion.

49. On July 11, 2003, the Appellants filed a Petition for Writ of Mandamus contending that they were entitled to certain documents in discovery, which Revenue contended were privileged. The Appellants also contended that they were entitled to additional written and oral discovery as well. (*Asworth*

Corporation et al v. Revenue Cabinet, Franklin Circuit Court, Civil Action No. 03-CI-00856).

50. On March 16, 2004, the Franklin Circuit Court issued an Order denying the Appellants' Petition for Writ of Mandamus.

51. On March 26, 2004, the Appellants filed a Motion to Alter, Amend, or Vacate Judgment regarding the Court's March 16, 2004 Order.

52. On April 22, 2004, the Court issued an Order and Opinion denying the Appellants' Motion to Alter, Amend, or Vacate, and ordering that "the 766 pages of disputed discovery collected and withheld by the Revenue Cabinet be entered into the record yet remain sealed and confidential." (April 23, 2004 Slip Op. at 8.)

53. On May 20, 2004, Revenue filed in the record at the Board of Tax Appeals a Notice of Filing Under Seal with the disputed discovery documents attached, and filed a Notice of Filing Under Seal with the Franklin Circuit Court, also on May 20, 2004.

54. The parties agree that the documents in dispute in Civil Action No. 03-CI-00856 and filed under seal in the record in this matter will be transferred to any reviewing court in the event of an appeal by either party of a final Board decision in this matter.

55. Professor Richard D. Pomp is qualified as an expert due to his knowledge, skill, experience, training, and education pursuant to KRE 702.

56. On August 21, 2002, the Appellants took a CR 30.02(6) deposition of Revenue by deposing Paul Jones (appointed by Revenue as its representative), who was at that time a Tax Consultant with the Division of Tax Policy, a veteran of over 30 years of employment with Revenue.

57. During the deposition, the attending court reporter recording and transcribing the deposition inadvertently failed to record a portion of the testimony of Mr. Jones. Upon discovery of the court reporter's omission after reviewing said transcript, counsel for the Appellants immediately contacted her and requested the tape recording of the deposition for review. The court reporter advised the Appellants' counsel that she had "erased" the tapes immediately following her transcription of the deposition.

58. The parties agree that the omitted testimony of Mr. Jones was essentially as follows: if one of the entities identified in KRS 141.040(a) through (h) (for example S corporations, 26 USC § 501 exempt corporations, or exempt or religious institutions, educational institutions, etc . . .) also met the requirements set forth in KRS 141.206 (i.e., were corporations both resident and non-resident which were partners in a partnership doing business in Kentucky), Revenue would hold that no tax would be owed pursuant to or under KRS 141.206 because this category of corporate partners are entities specifically exempted from income tax pursuant to KRS 141.040(a) through (h).

Respectfully submitted,

Dated: September 7, 2005

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No. 10-662

Supreme Court, U.S.
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IN THE

Supreme Court of the United States

ASWORTH, LLC (f/k/a Aswerth Corporation); HTF, LLC (f/k/a HT-Forum, Inc.); and D AVIATION SERVICES, LLC (f/k/a D Aviation Services, Inc.)

Petitioners,

v.

DEPARTMENT OF REVENUE, FINANCE AND ADMINISTRATION CABINET, COMMONWEALTH OF KENTUCKY (f/k/a Revenue Cabinet, Commonwealth of Kentucky)

Respondent.

ON PETITION FOR A WRIT OF CERTIORARI TO THE KENTUCKY COURT OF APPEALS

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RULE 29.6 STATEMENT

Petitioners' Corporate Disclosure Statement was set forth at page ii of their Petition for a Writ of Certiorari, and there are no amendments to that Statement.

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INTRODUCTION

For the below reasons, and those set forth in the Petition for a Writ of Certiorari, the Court should grant review on both questions presented by the Petitioners.

A. Physical Presence – *Quill Corp. v. North Dakota*

The question of whether physical presence is required before the income taxation of an out-of-state corporate partner is constitutional under the U.S. Commerce Clause, as required by this Court in *Quill Corp. v. North Dakota*, 504 U.S. 298 (1992), potentially affects millions of taxpayers. Likewise, it is an issue of constitutional significance as demonstrated by the express rejection by 35 or more state legislatures of this Court's holding in *Quill* through their enactment of statutes subjecting out-of-state companies to income taxation in the face of no in-state physical presence.

This situation is virtually identical to the one existing immediately before this Court's decision to hear *Quill*, when 36 states had enacted legislation rejecting the physical presence standard of *Nat'l Bellas Hess, Inc. v. Dep't of Revenue of Illinois*, 386 U.S. 753 (1967). Finally, the Kentucky lower court's decision is contrary to this Court's holding in *Quill*, and conflicts with other lower judicial and administrative decisions.

B. "Modest" Retroactivity – *United States v. Carlton*

United States v. Carlton, 512 U.S. 26 (1994), unequivocally sets forth the current test to determine if a non-curative, facially retroactive statute meets the

provisions of the Due Process Clause. Whether the retroactive legislation is "tax," "economic," "non-curative" or "remedial" legislation does not change the fact that *Carlton* requires that the period of statutory retroactivity be "modest." A 17-year retroactive change to a statute violates the *Carlton* modesty test.

This is simply the latest example of a state's blatant and improper revenue grab to come before the Court. The collective states must be called out on this conduct. As noted long ago by this Court, "The moral duty of a state to keep its word, in spirit as well as in letter, is no less than that of an individual." *Pacific Co. v. Johnson*, 285 U.S. 480, 501 (1932). By enacting retroactive legislation, the states are not honoring their word to their citizenry, so that the words of this Court seem particularly *apropos*: "A State, like a merchant, makes a contract. A dishonest State, like a dishonest merchant, willfully refuses to discharge it." *Chisholm v. Georgia*, 2 U.S. 419, 456 (1793); *see also Woodruff v. Trapnall*, 51 U.S. 190, 207 (1850) ("We naturally look to the action of a sovereign state, to be characterized by a more scrupulous regard to justice, and a higher morality, than belong to the ordinary transactions of individuals.").

Compelling reasons therefore require that this Court grant certiorari to review these fundamental principles of constitutional law and provide certainty to taxpayers and taxing jurisdictions.

C. Factual Clarification

Nearly all of the material facts were stipulated. Even so, Respondent has mischaracterized certain key facts.

Respondent first states that Petitioners erroneously suggested that the parties stipulated that Petitioners had no intangible property in Kentucky; however, that is not the case. It was stipulated between the parties that Petitioners had no real or tangible property in Kentucky, and the evidence of record was undisputed that Petitioners had no intangible property in Kentucky. Nor does Respondent allege the existence of *any* property interests in Kentucky. *See* Paul Jones Deposition ("Depo"), at 626-63; Respondent's Exh. 16 thereto and Transcript of Kentucky Board of Tax Appeals ("KBTA") Hearing on October 12, 2005 ("H.T."), at 121-24.

Respondent also mischaracterizes the investment versus operational nature of Petitioners' partnership interests in Conwood Company, LP ("Conwood") and Conwood Sales Co., LP. ("Conwood Sales"). The record is undisputed that Petitioners held the partnership interests of Conwood and Conwood Sales strictly as passive investment interests. *See* Edwin S. Roberson Depo, at 18, 25-27; Pet. App. 115a.

I. THE QUESTION OF WHETHER THE COMMERCE CLAUSE PERMITS TAXATION OF OUT-OF-STATE COMPANIES WITH ONLY "METAPHYSICAL PRESENCE" IS ONE OF GREAT PUBLIC IMPORTANCE

In determining whether to grant certiorari, the Court does not, contrary to Respondent's assertion, require a "real and embarrassing conflict of opinion and authority." Brief in Opposition ("Op. Br.") at 9, citing *Rice v. Sioux City Mem'l Park Cemetery*, 349 U.S. 70,

79 (1955) (quotations omitted). Respondent neglected to mention the alternative test for granting certiorari set forth in *Rice*, and misquotes the Court on this point; the Court actually stated that petitions should also be granted "... in cases involving principles the settlement of which is of importance to the public as distinguished from that of the parties ..." *Rice*, 349 U.S. at 79 (citation omitted). Review is also granted in instances of clear conflict. *See Langenkamp v. Culp*, 498 U.S. 42, 45 (1990).

Despite Respondent's claims to the contrary, this dispute is one of enormous importance to American business, as demonstrated by the Internal Revenue Service's own statistics confirming that 3,146,000 partnership income tax returns were filed in 2008 alone. *See* http://www.irs.gov/pub/irs-soi/08pareturnsnap.pdf (last visited Jan. 3, 2011).

Respondent's assertion that the Court should deny the Petition because states have enacted legislation providing for the taxation of out-of-state companies with no in-state physical presence is flawed. Before this Court's decision in *Quill*, 36 states had enacted legislation ignoring *Bellas Hess* and subjecting out-of-state companies with no in-state physical presence to collect use tax.[1] This Court has consistently interpreted the Commerce Clause "to ensure that States do not disrupt or burden interstate commerce when Congress' power remains unexercised: it protects the free flow of commerce, and thereby safeguards Congress' latent power from encroachment by the several States."

1. *See* Laura A. Kulwicki, *State Taxation of Mail Order Sellers: An End to the Nexus Wars?*, STATE TAX NOTES, Nov. 11, 1991, at 332.

Merrion v. Jicarilla Apache Tribe, 455 U.S. 130, 154 (1982). 35 states' enactment of legislation blatantly ignoring *Quill* demonstrates the widespread nature of the "quagmire" that still exists nearly 20 years after *Quill*. Indeed:

> . . . it has long been "accepted constitutional doctrine that the commerce clause, without the aid of Congressional legislation . . . affords some protection from state legislation inimical to the national commerce, and that in such cases, where Congress has not acted, this Court, and not the state legislature, is under the commerce clause the final arbiter of the competing demands of state and national interests."

Japan Line, Ltd, v. County of Los Angeles, 441 U.S. 434, 454 (1979) (citation omitted).[2] As Congress has not acted in the nearly 20 years since *Quill*, this Court should step in.

Rejection of *Quill* in income tax cases is inconsistent with international tax policy requiring foreign taxpayers to have a "permanent establishment in the United States before the federal government can tax its profits." *See* Megan A. Stombock, *Economic Nexus and Nonresident Taxpayers: How Far Will It Go?*, 61 Tax Law. 1225, 1239 (Summer 2008). The merit of a bright-

2. *See also* Donald M. Griswold and Sara A. Lima, *An Apology Revisited: Intercompany Licensing of Intangibles In an Age of Tax Amnesties, Capitulation, and Judicial Confusion*, 15 Multistate Tax Report 189, 200, n. 46 (BNA Tax Management, Inc. 2008).

line rule "lies in the clarity of its command and the certainty of its application." *Minnick v. Mississippi*, 498 U.S. 146, 151 (1990). It is also illogical to require physical presence for use tax collection, yet only require metaphysical presence for income tax – after all, "we must never forget that it is a *constitution* we are expounding." *McCulloch v. Maryland*, 17 U.S. 316, 407 (1819).

How far can a State go? Without this Court's intervention, such disparate tax treatment will continue to create havoc for millions of American and foreign taxpayers.

II. THE COURTS ARE IN CONFLICT REGARDING WHETHER THE COMMERCE CLAUSE PROHIBITS STATE TAXATION OF OUT-OF-STATE COMPANIES WITH ONLY "METAPHYSICAL PRESENCE"

Respondent's strained efforts to portray this issue as settled only result in confirming that the issue is in chaotic conflict throughout the courts. While there are some factual distinctions in the conflicting cases, the truth is that the appellate courts of Tennessee, Texas and Michigan have issued decisions in accordance with *Quill*, contrary to the Kentucky lower court's decision and many other state court and administrative decisions. [Pet. at 19-21]. These decisions are in addition to the other decisions referred to in the Petition, which stands as submitted. The map and table of the *Quill* controversy [Pet. App. 120a-124a] demonstrate that courts frequently render decisions involving physical presence or metaphysical presence issues with

conflicting results. *See, e.g., KFC Corp. v. Iowa Dep't of Revenue*, No. 09-1032 (Iowa Dec. 30, 2010), issued only days ago, where the court rejected *Quill*.

In addition to the conflicting situations discussed in the Petition, countless state tax commentators have lamented the conflicts among the lower courts on this issue and the need for this Court to review the issue and determine whether physical or metaphysical presence is required before an out-of-state company is subjected to income taxation. *See, e.g.*, Jeffrey A. Friedman et al., *The U.S. Supreme Court Should Accept a Nexus Case*, State Tax Notes, Jul. 6, 2009, at 42; Scott D. Smith and Sharlene Amitay, *Economic Nexus: An Unworkable Standard for Jurisdiction*, State Tax Notes, Sept. 9, 2002, at 787.

The *Quill* map also highlights the states ignoring this Court. Lower courts are duty-bound to apply a directly applicable precedent unless that precedent has been explicitly or implicitly overruled: "If a precedent of this Court has direct application in a case, yet appears to rest on reasons rejected in some other line of decisions, the [lower courts] should follow the case which directly controls, leaving to this Court the prerogative of overruling its own decisions." *Rodriguez de Quijas v. Shearson/Am. Express, Inc.*, 490 U.S. 477, 484 (1989); *see also Illinois v. Krull*, 480 U.S. 340 (1987).

III. THE KENTUCKY DECISION IS CONTRARY TO *QUILL* REQUIRING PHYSICAL PRESENCE UNDER THE COMMERCE CLAUSE BEFORE STATE TAXATION[3]

In *Quill*, this Court held that "substantial nexus" under the *Complete Auto Transit, Inc. v. Brady*, 430 U.S. 274 (1977) test means "physical presence." *Quill*, 504 U.S. at 317. Despite Respondent's contrary rhetoric, *Quill* did *not* limit the application of the physical presence requirement to use taxes. Outwardly rejecting a case is one thing; this Court specifically stating that it was *not* doing so is entirely different:

> we have never intimated a desire to reject all established "bright-line" tests. Although we have not, in our review of other types of taxes, articulated the same physical-presence requirement that *Bellas Hess* established for sales and use taxes, that silence does *not* imply repudiation of the *Bellas Hess* rule.

Quill, 504 U.S. at 314 (emphasis added). *Bellas Hess*' continued vitality regarding physical presence and the Commerce Clause was confirmed by its citation only months ago. *See Hemi Group, LLC v. City of New York*, 130 S.Ct. 983, 994 (U.S. 2010).

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3. Although Respondent claims that the lower court properly relied on *Borden Chemicals and Plastics, LP v. Zehnder*, 726 N.E.2d 73 (Ill. App. 2000), that case must be distinguished because there the taxpayer *stipulated* that it was subject to taxing jurisdiction. *Borden Chemicals*, 726 N.E.2d at 77.

Well-respected state and local tax commentators have confirmed that income taxes apply to out-of-state taxpayers only if they have in-state physical presence. *See, e.g.*, Griswold, *supra*, at 199. Professor Richard D. Pomp testified below that *Quill* applies to income taxes because:

> when *Quill* talks about physical presence as being the nexus standard, that is one nexus standard. We don't have a separate Commerce Clause for income taxes or property taxes. We have one Commerce Clause.

H.T. at 172-173.

IV. *CARLTON* REQUIRES "MODEST" RETROACTIVITY; 17 YEARS IS BY DEFINITION "IMMODEST"

A. Interest Accrues On Petitioners' Refunds – No "As Written" Constitutional Challenge Is Presented

Respondent's Brief in Opposition mischaracterizes the interest provisions of Kentucky law insofar as the suggestion is made to the Court that interest is inapplicable. Op. Br. at 5, 26-28. Thus, Respondent misstates the governing authorities and the applicable analysis. Kentucky law is clear that interest is due and owing to any taxpayer otherwise overpaying its taxes; this action is no different. Ky. Rev. Stat. § 134.580(1)&(4).

Ky. Rev. Stat. § 134.590 admittedly does not provide for interest in two circumstances: (i) ad valorem taxes,

and (ii) taxes imposed pursuant to a *statute* held unconstitutional. Petitioners are not now, nor have they ever, alleged that Ky. Rev. Stat. § 141.040 or Ky. Rev. Stat. § 141.206 are unconstitutional *as written*. Throughout the entirety of this proceeding, Petitioners have alleged that Kentucky statutes require Ky. Rev. Stat. § 141.040 and Ky. Rev. Stat. § 141.206 to be read *in pari materia* in light of applicable constitutional doctrine. When the statutes are properly construed, the conclusion is that Petitioners do not have nexus with Kentucky, resulting in an overpayment of tax and refund interest under Ky. Rev. Stat. § 134.580.

Respondent has always recognized that Petitioners have alleged that Ky. Rev. Stat. § 141.206 violates the Commerce Clause on an "as applied" basis. *See, e.g.*, Respondent's Reply Brief to the Franklin Circuit Court filed November 14, 2006 at 6; Petitioners' Response Brief to the Franklin Circuit Court filed October 18, 2006 at 22. Neither of these two arguments suggest that Ky. Rev. Stat. § 141.040 or Ky. Rev. Stat. § 141.206 are unconstitutional as written. Respondent's arguments that Ky. Rev. Stat. § 134.590 somehow preempts and prohibits interest from accruing on the overpayments are simply wrong as a matter of law. *See, e.g., Maximum Machine Co. v. City of Shepherdsville*, 17 S.W.3d 890 (Ky. 2000); *St. Ledger v. Kentucky Revenue Cabinet*, 942 S.W.2d 893 (Ky. 1997); *Revenue Cabinet v. Gossum*, 887 S.W.2d 329 (Ky. 1994).

B. The Bills Are Unconstitutionally Retroactive Under *Carlton*

Other arguments advanced by Respondent, as they relate to *Carlton* and the particulars of this case, miss

the mark as well. Specifically, Respondent's suggestion that House Bills 704 and 216 are of "modest" retroactive application fail by their own terms. Here, the period of retroactivity is 17 years [back to 1993], and far exceeds the "modest" boundaries required under the *Carlton* doctrine.

Respondent also suggests that the Bills were not "tax or economic legislation" [Op. Br. at 30], but rather that the Bills were "remedial" legislation. *Id.* This, too, is inaccurate and unsupported by the record. Respondent's policy assertions also fail as to why an interest rate differential is otherwise appropriate. Respondent advances among other reasons that commercial lenders charge more to loan money than they pay on deposits (such deposits forming the loan base that is effectively loaned out at a higher rate), as justification for the wisdom behind the interest changes enacted by the Kentucky General Assembly. *See* Op. Br. at 3-4. Even Respondent recognizes that the legislation has *economic* and *tax* overtones – to further allege that the Bills were not tax legislation is simply wrong. The expressed legislative purpose of the Bills was to amend Kentucky's tax statutes.

The "policy" asserted by Respondent as to *why* the Bills are appropriate legislation is (i) not supported by the record nor (ii) logical. Taken to its extreme, this "policy" would mean that the states "borrow" from its citizens at a rate materially less than that paid to its citizens. This is the exact fear advanced by this Court, albeit on the other foot: "A rate of interest on tax delinquencies which is low in comparison to the taxpayer's borrowing rate – if he can borrow at all – is a

temptation to use the state as a convenient, if voluntary, banker by the simple practice of deferring the payment of taxes." *Meilink v. Unemployment Reserves Comm'n of State of California*, 314 U.S. 564, 567 (1942).

For Respondent to now argue that the legislation was "remedial" is to liken it to a "curative" legislative act; the record is void of any such evidence. Assuming *arguendo* that it was "remedial" in nature, what was the legislature trying to remediate? If the legislation were "remedial," it was effectively making a retroactive change to legislation first enacted some 18 years previously, which undoubtedly calls into consideration the *Carlton* modesty analysis.

As to the conflict throughout the Country on the *Carlton* modesty issue and Respondent's views to the contrary, the cases set forth in the Petition stand as submitted. When taken as a whole, these are compelling, prompting reasonable minds to conclude that there is a difference of opinion on the *Carlton* modesty Due Process benchmark, which continues to this day. Only days ago, a lower court ruled that a legislative tax act having a retroactive period of 24 years violated Due Process under *Carlton*'s modesty test. *Tesoro Ref. and Mktg. Co. v. State of Washington*, No. 39417-1-II (Wash. App. Dec. 21, 2010). Not only is there a conflict, but the gulf among the states grows wider with each passing month. As to the several antiquated cases cited by Respondent, Petitioners' response is that they are all pre-*Carlton*.[4]

4. Respondent relies upon *Morley v. Lake Shore & M.S. Ky. Co.*, 146 U.S. 162 (1892), to somehow suggest that it controls. The legislation in *Morley* was by its own terms *not* retroactive. At best, *Morley* is inapposite.

The problem with the Bills is Kentucky's express desire to take tax money in the form of tax refund interest dollars and do so on an unlimited retroactive basis; by definition an "immodest" reach for the non-curative change. A decision now is needed. As this Court has noted, "[s]tudents of federal taxation agree that the tax system suffers from delay in getting the final word in judicial review, from retroactivity of the decision when it is obtained, and from the lack of a roundly tax-informed viewpoint of judges." *Dobson v. Comm'r of Internal Revenue*, 320 U.S. 489, 500 (1943).

CONCLUSION

For the foregoing reasons, and those stated in the Petition for a Writ of Certiorari, the Petition should be granted, and this case should be heard.[5]

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5. Alternatively, this Court should issue a "Grant, Vacate and Remand" Order to the Supreme Court of Kentucky.

82 (4)

No. 10-662

Supreme Court, U.S.
FILED
FEB 18 2011
OFFICE OF THE CLERK

IN THE

Supreme Court of the United States

ASWORTH, LLC (f/k/a Asworth Corporation); HTF, LLC (f/k/a HT-Forum, Inc.); and D AVIATION SERVICES, LLC (f/k/a D Aviation Services, Inc.)

Petitioners,

v.

DEPARTMENT OF REVENUE, FINANCE AND ADMINISTRATION CABINET, COMMONWEALTH OF KENTUCKY (f/k/a Revenue Cabinet, Commonwealth of Kentucky)

Respondent.

ON PETITION FOR A WRIT OF CERTIORARI TO THE KENTUCKY COURT OF APPEALS

PETITION FOR REHEARING

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Acting under Supreme Court Rule 44.2, Petitioners Asworth, LLC (f/k/a Asworth Corporation), HTF, LLC (f/k/a HT-Forum, Inc.) and D Aviation Services, LLC (f/k/a D Aviation Services, Inc.) (collectively, "Petitioners" or "Asworth") respectfully request rehearing of the Court's Order denying their Petition for a Writ of Certiorari. Such request, as demonstrated by appropriate certificate, is based on intervening circumstances of substantial effect and impact.

PETITION FOR REHEARING

Petitioners respectfully request rehearing of the Court's Order[1] dated January 24, 2011, denying the Petition for a Writ of Certiorari in this case.

GROUNDS FOR REHEARING

Central to the underlying Petition for Certiorari and this Petition for Rehearing is this Court's opinion in *Quill Corp. v. North Dakota*, 504 U.S. 298 (1992). *Quill* is also central to two other Petitions for Certiorari pending before this Court which were docketed after the Petition for Certiorari herein was docketed. All three Petitions present the question whether *Quill*'s physical presence requirement is applicable to all types of state taxes (*e.g.*, income tax and ad valorem property tax) or is limited to sales and use taxes.

In *Quill*, which involved North Dakota's imposition of use tax on goods sent from out of state into North Dakota,

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1. Rehearing is requested only regarding Question 1, involving whether Kentucky violated the Commerce Clause by subjecting out-of-state taxpayers to income tax in the face of those taxpayers having no in-state physical presence.

this Court held that physical presence of a taxpayer is required to establish constitutionally sufficient nexus with the taxing state under the Commerce Clause. However, since the Court's decision in *Quill* and for nearly 20 years, states have been in conflict over whether the physical presence rule set forth in *Quill* is limited only to sales and use taxes, or is applicable to all state taxes. *See* Petition, Appendices J and K, and Reply Brief, *Asworth et al. v. Dep't of Revenue*, No. 10-662 (U.S. 2010) (evidencing the split between states concerning the application of *Quill* to taxes other than sales and use).

On March 12, 2010, in a case directly traceable to *Quill*, the Supreme Court of Texas declined review of the Texas Court of Appeals' decisions in *Peoples Gas, Light and Coke Co. v. Harrison Cent. Appraisal Dist.*, 270 S.W.3d 208 (Tex. App. Sept. 24, 2008) and *Midland Cent. Appraisal Dist. v. BP Am. Prod. Co.*, 282 S.W.3d 215 (Tex. App. Mar. 26, 2009). On October 1, 2010, the Supreme Court of Texas denied rehearing of both decisions. *See Id.*

On December 30, 2010, Harrison Central Appraisal District filed with this Court a Petition for a Writ of Certiorari to the Texas Court of Appeals of the above decision. That same day, Midland Central Appraisal District also filed a Petition for a Writ of Certiorari to the Texas Court of Appeals regarding the decision in its case.[2] *See* Docket, *Harrison Cent. Appraisal Dist. v.*

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2. To further demonstrate the significance of the issues involved in these cases, discussed *infra*, seven amicus briefs in support of Petitioners' request for certiorari have since been filed in these two actions. *See* Docket, *Harrison Cent. Appraisal Dist. v. Peoples Gas, Light and Coke Co.*, No. 10-896 (U.S. Dec. 30, 2010); Docket, *Midland Cent. Appraisal Dist. v. BP Am. Prod. Co.*, No. 10-890 (U.S. Dec. 30, 2010), *available at*: http://www.supremecourt.gov/docket/docket.aspx (last visited Feb. 18, 2011).

Peoples Gas, Light and Coke Co., No. 10-896 (U.S. Dec. 30, 2010); Docket, *Midland Cent. Appraisal Dist. v. BP Am. Prod. Co.*, No. 10-890 (U.S. Dec. 30, 2010), *available at*: http://www.supremecourt.gov/docket/docket.aspx (last visited Feb. 18, 2011).

Petitioners in the instant action filed their Petition for a Writ of Certiorari to the Kentucky Court of Appeals ("Petition") regarding a decision holding contrary to those of the Texas Court of Appeals on November 16, 2010, well before the Petitions in *Harrison Cent. Appraisal Dist. v. Peoples Gas, Light and Coke Co.*, No. 10-896 (U.S. Dec. 30, 2010) and *Midland Cent. Appraisal Dist. v. BP Am. Prod. Co.*, No. 10-890 (U.S. Dec. 30, 2010) were docketed with this Court.[3] Thus, the filing of petitions for certiorari in the Texas cases constitutes an intervening circumstance warranting rehearing of the denial of certiorari.[4]

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3. Presumably, the Court was not aware of the Texas cases at the time of its denial of certiorari in *Asworth* as the requisite filings therein have not been completed and the cases have not yet been set for conference by the Court.

4. The Court has granted rehearing in cases where the grounds for rehearing were based on a filing of a petition for certiorari in a related case or a state court decision changing applicable state law. *See Florida v. Rodriguez*, 461 U.S. 940 (1983) (granting rehearing of a denial of certiorari when the state filed a Petition for a Writ of Certiorari in a related case); *Conner v. Simler*, 367 U.S. 486 (1961) (granting rehearing of a denial of certiorari when a new state court decision changed applicable state law in a diversity case). Where the Court has granted certiorari in another case raising identical or similar issues – particularly if that case is in direct conflict with the one in which review was previously denied – this Court has even vacated its denial of certiorari *sua sponte* and granted review. *See* E. Gressman et al., SUPREME COURT PRACTICE at 821 (9th ed. 2007) (citing *Bowden v. Fort Smith*, 316 U.S. 584, [illegible] (1942); *Helvering v. Spouse*, 316 U.S. 656 (1942), 318 U.S. 604 (1943)).

Harrison Central and *Midland Central* involve Texas' imposition of ad valorem property tax on oil and gas located in the State and connected to a pipeline system for interstate transport. *See Peoples Gas, Light and Coke Co. v. Harrison Cent. Appraisal Dist.*, 270 S.W.3d at 211; *Midland Cent. Appraisal Dist. v. BP Am. Prod. Co.*, 282 S.W.3d at 218. The Texas Court of Appeals held that ad valorem property tax on oil and gas stored in the State but connected to an interstate pipeline system for out-of-state transport violated the Commerce Clause of the U.S. Constitution because the oil and gas were "in transit" in interstate commerce and because the taxpayers did not have substantial nexus (à la *Quill*) under *Complete Auto Transit, Inc. v. Brady*, 430 U.S. 274 (1977). *See Peoples Gas, Light and Coke Co. v. Harrison Cent. Appraisal Dist.*, 270 S.W.3d at 218; *Midland Cent. Appraisal Dist. v. BP Am. Prod. Co.*, 282 S.W.3d at 223.

In so holding, and as noted by all related filings to date now before the Court, the Texas Court of Appeals' decisions are in direct conflict with the Oklahoma Supreme Court's decision in *Missouri Gas Energy v. Schmidt*, 234 P.3d 938 (Okla. 2008), *cert. denied*, 130 S.Ct. 1685 (2010) on the "in transit" issue, as both the Texas and Oklahoma courts employed differing Commerce Clause analyses, relevant here on how each interpreted *Quill*. This Court, in noting the importance of the issues involved herein, requested the Solicitor General's views in *Missouri Gas*. The Solicitor General asserted that the Oklahoma Supreme Court's analysis was correct.[5] *See* Brief of the United States as Amicus Curiae, *Missouri Gas*, No. 08-1458 (Jan. 26, 2010).

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5. Respectfully, the Court should similarly request the Solicitor General's opinion in the instant action – as it relates to

This conflict raises even broader concerns concerning whether the physical presence of a taxpayer is required to establish nexus in the taxing state. *See* Petition for a Writ of Certiorari at 9, *Harrison Central*, No. 10-896 (U.S. Dec. 30, 2010) ("[i]s the physical presence of the taxpayer by activities in the taxing state necessary to establish nexus?"); Petition for a Writ of Certiorari at 10, *Midland Central*, No. 10-890 (U.S. Dec. 30, 2010) ("whether a 'physical-presence' rule, which the Court has held remains applicable in analyzing Commerce Clause challenges to state *sales* and *use* taxation, *Quill*, 504 U.S. [298] at 312-14, likewise applies to ad valorem *property* taxation."). *See* Petition for a Writ of Certiorari at 25, *Asworth*, No. 10-662 (U.S. Nov. 16, 2010) ("such a shifting test, one requiring physical presence in sales and use taxes while allowing 'metaphysical presence' in income tax cases, would create unconscionable results.").

In *Asworth*, the Kentucky Court of Appeals addressed the same issue, whether taxpayers had substantial nexus under *Complete Auto* and *Quill*, but rejected this Court's physical presence requirement of *Quill*. The Kentucky Court of Appeals consequently subjected the out-of-state taxpayers to income tax even though they had no property or employee presence whatsoever in Kentucky. *See Asworth et al. v. Dep't of Revenue*, Nos. 2007-CA-00259 & 2008-CA-000023 (Ky. App. Nov. 20, 2009), *review denied*, No. 2009-SC-0816 (Ky. Aug. 18, 2010).

On the other hand, the Texas Court of Appeals applied the *Complete Auto* and *Quill* physical presence

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whether a physical presence requirement applies in the context of state taxes, other than sales and use, as the Solicitor General in *Missouri Gas did not* opine as to the *Quill* issue in any material manner.

requirement broadly as to effectively shield taxpayers *with* a presence of property – oil and gas, underground storage facilities and pipelines – in the State from ad valorem property taxation. *See Harrison Central*, 270 S.W.3d 208 (Tex. App. Sept. 24, 2008); *Midland Central*, 282 S.W.3d 215 (Tex. App. Mar. 26, 2009).

These cases are completely at odds with each other, and, simply put, result in a direct and current conflict. The Texas courts have held in favor of the taxpayers, applying a *Quill* physical presence analysis outside of the sales and use tax arena to ad valorem property taxation; the Kentucky court has held in favor of the State, limiting *Quill*'s physical presence analysis to sales and use taxes, and expressly rejecting its application to income taxes. As Chief Justice John Marshall described, "That may be very clear to one intellect, which is far from being so to another." *Ogden v. Saunders*, 25 U.S. 213, 339 (1827). The Court's denial of rehearing in *Asworth* would leave in place an opinion in direct conflict with *Harrison Central* and *Midland Central*, one which is patently irreconcilable.

No different than with sales and use taxation and its fiscal significance, of critical importance to states and businesses is whether the *Quill* physical presence requirement applies in the context of income and property taxes, given that these three types of taxes are generally the main sources of revenue for states. Significantly, income tax is Kentucky's second greatest source of revenue (37.9%), behind only sales and use tax (47.8%). *See* United States Census Bureau, *2009 Survey of State Government Tax Collections*, *available at*: http://www.census.gov/govs/statetax/0918kystax.html (last visited Feb. 18, 2011). Ad valorem property tax is Texas' greatest source of revenue (47.8%), and sales and use tax is its second (32.1%). *See*

Texas Comptroller of Public Accounts, *Window on State Government*, *at*: http://www.window.state.tx.us.taxinfo/proptax/annual09/ch01.html (last visited Feb. 18, 2011). Thus, the magnitude of whether *Quill*'s physical presence requirement applies for taxpayers (in Texas) or does not apply (in Kentucky) is enormous, has a wide-ranging effect upon the majority of taxpayers of each state and is largely determinative of each state's budget. Further, it would be illogical to have one standard for sales and use tax and another for all other state taxes throughout the Country, including income and property taxes.

Asworth, *Harrison Central* and *Midland Central* are all currently pending before this Court. It does not appear that multiple Petitions for Certiorari raising the question of the proper application of *Quill* have been pending before the Court at the same time since *Quill* was decided in 1992; similarly, never before have such pending Petitions been in direct conflict as to its application.

This is a perfect storm, which not only demonstrates the importance of this issue, but presents the first opportunity in 20 years for this Court to address whether physical presence/*Quill* applies to all state taxes (in particular, to income and ad valorem property taxes, or is limited to sales and use taxes) by reference to simultaneously presented conflicting decisions involving two different taxes in two different states. As Justice Frankfurter noted in *Kinsella v. Krueger*, 351 U.S. 470, 485 (1956), "[r]eflection is a slow process. Wisdom, like good wine, requires maturing." As nearly 20 years have passed since the Court's decision in *Quill*, the Court's wisdom is now needed as to how *Quill* should be applied today.

This Court's review of whether a State violates the Commerce Clause by subjecting taxpayers to state tax when the taxpayers have no physical presence in the State should be addressed at this time because the states are in chaos over the unsettled nature of the law post-*Quill*.[6] This Court recognized generations ago that "[u]ncertainty and ambiguity are the bane of commerce." *Merritt v. Welsh*, 104 U.S. 694, 702 (1881). The framers of the U.S. Constitution intended that the Commerce Clause have the same meaning in Kentucky as it does in Texas, and among all states. This Court should grant review of Asworth's Petition to clarify the scope of *Quill*'s physical presence requirement and provide nationwide uniformity for the application of the Commerce Clause.

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6. This chaotic state of affairs is demonstrated by yet another *Quill*-like case, a decision issued by the Supreme Court of Washington only weeks ago, on January 20, 2011. *See Lamtec Corp. v. Dep't of Revenue*, --- P.3d ---, 2011 WL 173070 (Wash. 2011).

CONCLUSION

For the foregoing reasons, Petitioners respectfully request that the Court grant their Petition for Rehearing and Petition for a Writ of Certiorari.[7]

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7. Alternatively, Petitioners respectfully request that the Court hold this Petition in abeyance pending the Court's decisions as to whether to grant or deny Certiorari in *Harrison Central* and *Midland Central* or issue a "Grant, Vacate and Remand" Order to the Supreme Court of Kentucky.

CERTIFICATE OF GOOD FAITH

The undersigned hereby certifies that this petition for rehearing is restricted to the grounds specified in Rule 44.2 of the Rules of the Supreme Court and is presented in good faith and not for delay.

